

# Inspector General

United States  
Department of Defense



Air Force Space and Missile Systems Center's Use  
of Undefined Contractual Actions

Report Documentation Page				Form Approved OMB No. 0704-0188	
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1. REPORT DATE <b>16 DEC 2010</b>		2. REPORT TYPE		3. DATES COVERED <b>00-00-2010 to 00-00-2010</b>	
4. TITLE AND SUBTITLE <b>Air Force Space and Missile Systems Center's Use of Undefined Contractual Actions</b>				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S)				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) <b>Department of Defense Office of Inspector General, 400 Army Navy Drive, Arlington, VA, 22202-4704</b>				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES)				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION/AVAILABILITY STATEMENT <b>Approved for public release; distribution unlimited</b>					
13. SUPPLEMENTARY NOTES					
14. ABSTRACT					
15. SUBJECT TERMS					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT <b>Same as Report (SAR)</b>	18. NUMBER OF PAGES <b>63</b>	19a. NAME OF RESPONSIBLE PERSON
a. REPORT <b>unclassified</b>	b. ABSTRACT <b>unclassified</b>	c. THIS PAGE <b>unclassified</b>			

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## Acronyms and Abbreviations

DCAA	Defense Contract Audit Agency
DFARS	Defense Federal Acquisition Regulation Supplement
DPAP	Defense Procurement and Acquisition Policy
EELV	Evolved Expendable Launch Vehicle
FAR	Federal Acquisition Regulation
FPDS-NG	Federal Procurement Data System-Next Generation
GAO	Government Accountability Office
IG	Inspector General
PNM	Price Negotiation Memorandum
SMC	Space and Missile Systems Center
UCA	Unfinitized Contractual Action
U.S.C.	United States Code



INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
400 ARMY NAVY DRIVE  
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December 16, 2010

MEMORANDUM FOR UNDER SECRETARY OF DEFENSE FOR ACQUISITION,  
TECHNOLOGY, AND LOGISTICS  
UNDER SECRETARY OF DEFENSE (COMPTROLLER)/  
CHIEF FINANCIAL OFFICER  
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL  
MANAGEMENT AND COMPTROLLER)

SUBJECT: Air Force Space and Missile Systems Center's Use of Undefined  
Contractual Actions (Report No. D-2011-024)

We are providing this report for your information and use. We considered management comments on a draft of this report when preparing the final report. This report is the third in a series of reports and is part of a congressionally mandated periodic review of DoD use of undefined contractual actions. Air Force Space and Missile Systems Center personnel did not consistently comply with statutory and DoD requirements for managing undefined contractual actions, resulting in the Air Force assuming additional risk in the award and negotiation process and possibly paying more profit than necessary.

The comments from the Director of Contracting, Air Force Space and Missile Systems Center, conformed to the requirements of DoD 7650.3. Therefore, no additional comments are required.

We appreciate the courtesies extended to the staff. Please direct questions to me at (703) 604-9201 (DSN 664-9201).

A handwritten signature in black ink, reading "Richard B. Jolliffe", is positioned above the printed name.

Richard B. Jolliffe  
Assistant Inspector General  
Acquisition and Contract Management







# Results in Brief: Air Force Space and Missile Systems Center's Use of Undefinitized Contractual Actions

## What We Did

Public Law 99-591, section 908(b) requires the DoD Inspector General to periodically audit undefinitized contractual actions (UCAs) and submit a report to Congress. This is the third in a series of reports discussing DoD compliance with section 2326, title 10, United States Code.

We reviewed 27 UCAs with a total not-to-exceed value of about \$4.8 billion awarded by the Air Force Space and Missile Systems Center (SMC) during FY 2004 through September 18, 2009, to determine whether SMC personnel complied with the restrictions of the United States Code and whether they appropriately justified and definitized UCAs at reasonable prices.

## What We Found

SMC officials did not consistently comply with statutory and DoD requirements for managing UCAs for 26 of the 27 UCAs that we reviewed. SMC personnel did not:

- properly prepare a request for authorization to issue 1 UCA,
- definitize 18 UCAs within the 180-day time frame,
- reflect the contractor's reduced risk during the undefinitized period in negotiated profit for 3 UCAs,
- adequately support whether the contractor's reduced risk was reflected in negotiated profit for 11 UCAs,
- obligate funds within allowable limits for 3 UCAs, or
- obligate funds according to contractor spending requirements for 9 UCAs.

However, SMC contracting personnel adequately justified using all 27 UCAs we reviewed and adequately documented their determination of price reasonableness for 26 of the UCAs.

SMC personnel did not consistently comply with UCA restrictions because:

- they did not fully explain the need to begin performance before definitization within the UCA authorization request;
- contractors submitted inadequate proposals, the Air Force changed requirements after SMC personnel issued the UCAs, and the procurements were overly complex and large;
- they inappropriately determined that the weighted guidelines did not provide adequate profit;
- they did not adequately document the basis for determination of profit; and
- they did not take steps to implement the Office of Defense Procurement and Acquisition Policy requirements for obligating funds.

As a result, the Air Force assumed increased risk in the award and negotiation process and may have paid more profit than was necessary.

## What We Recommend

Air Force officials should develop a metric for measuring contractor responsiveness in preparing qualifying proposals, require better coordination with customers to identify changes in Government requirements, and require contracting personnel to adequately document the profit determination for UCAs.

## Management Comments and Our Response

The Director of Contracting, Air Force Space and Missile Systems Center, agreed with our recommendations and provided responsive comments on the recommendations. No further comments are required. Please see the recommendation table on the back of this page.

## Recommendations Table

Management	Recommendations Requiring Comment	No Additional Comments Required
Director of Contracting , Air Force Space and Missile Systems Center		1-6

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# Introduction

## Audit Objectives

We determined Air Force Space and Missile Systems Center (SMC) compliance with restrictions on undefinitized contractual actions (UCAs) imposed by section 2326, title 10, United States Code (10 U.S.C. § 2326 [2009]), “Undefinitized contractual actions: restrictions.” We also determined whether UCAs were appropriately justified and definitized at reasonable prices. This is the third in a series of reports discussing DoD compliance with 10 U.S.C. § 2326 (2009). See Appendix A for the scope and methodology and prior coverage related to the objectives.

## Legislation and Congressional Report Requirement

The DoD Inspector General (IG) is required by Public Law 99-591, “Continuing Appropriations for Fiscal Year 1987,” section 908(b), to periodically conduct an audit of UCAs. DoD IG Report No. D-2004-112, “Undefinitized Contractual Actions,” August 30, 2004, was our last audit of UCAs. Section 908(b) of Public Law 99-591 states:

Oversight by Inspector General.—The Inspector General of the Department of Defense shall—

- (1) periodically conduct an audit of contractual actions under the jurisdiction of the Secretary of Defense (with respect to the Defense Logistics Agency) and the Secretaries of the military departments; and
- (2) after each audit, submit to Congress a report on the management of undefinitized contractual actions by each Secretary, including the amount of contractual actions under the jurisdiction of each Secretary that is represented by undefinitized contractual actions.

## Background on Undefinitized Contractual Actions

UCAs are agreements that allow a contractor to begin work and incur costs before the Government and the contractor have reached a final agreement on contract terms, specifications, or price. Contracting officers should use UCAs only when the negotiation of a definitive contractual action is not possible in sufficient time to meet the Government’s requirement. The Government’s requirement must also demand that the contractor be given a binding commitment so that contract performance can begin immediately.

### ***UCA Restrictions***

Section 2326, title 10, United States Code, requires that the request to issue a UCA be sent to the head of an agency, contain the anticipated impact on agency requirements if a UCA is not used, and establish limitations on the obligation of funds, the definitization of terms, and allowable profit for UCAs. The Government limits the use of UCAs because these contracts place the Government at a distinct disadvantage in negotiating final prices.

UCAs for foreign military sales, purchases that do not exceed the simplified acquisition threshold, special access programs, and congressionally mandated long-lead procurement contracts are not subject to compliance with 10 U.S.C. § 2326, but must comply with Defense Federal Acquisition Regulation Supplement (DFARS) 217.74, “Undefinitized Contract Actions,” to the maximum extent practicable. Both 10 U.S.C. § 2326 and the DFARS provide additional restrictions for the approval, definitization, obligation of funds, and determination of allowable contractor profit.

Specifically, to determine whether UCAs issued by SMC contracting personnel were in compliance, we reviewed the following four areas:

- **Authorization to Use a UCA:** We evaluated whether contracting personnel issued UCAs only after obtaining proper authorization. Additionally, we reviewed the requests to issue a UCA to verify that the requests adequately addressed potential adverse impacts on agency requirements if a UCA was not issued.
- **Contract Definitization:** We evaluated whether SMC personnel definitized UCAs within 180-day time limits.
- **Allowable Profit:** We evaluated whether SMC contracting personnel’s determination of contractor profit reflected the work performed during the undefinitized period.
- **Compliance With Obligation Limitations:** We evaluated whether SMC contracting personnel obligated funding within allowable amounts.

We also reviewed UCAs to determine whether SMC personnel appropriately justified the UCAs and whether the UCAs were definitized at fair and reasonable prices. In addition, we reviewed UCAs issued after August 2008, to determine whether SMC personnel obligated funds according to the requirements stated in the Office of Defense Procurement and Acquisition Policy (DPAP) memorandum, “Management Oversight of Undefinitized Contract Actions,” August 29, 2008, (August 2008 DPAP memorandum).

### ***Enhanced Reporting Requirements***

The August 2008 DPAP memorandum also required semiannual reporting of DoD UCA usage for actions with an estimated value of more than \$5 million. See Appendix B for a copy of the memorandum. DPAP introduced the enhanced reporting requirement in response to the Government Accountability Office (GAO) Report No. GAO-07-559, “Defense Contracting: Use of Undefinitized Contract Actions Understated and Definitization Time Frames Often Not Met,” June 2007, and Public Law 110-181, “The National Defense Authorization Act for Fiscal Year 2008,” section 809, “Implementation and Enforcement of Requirements Applicable to Undefinitized Contractual Actions.”

### ***DFARS Case Rulings***

The 2007 GAO audit report resulted in DFARS Case 2007-D011, which clarified that, per 10 U.S.C. § 2326, the direction in DFARS 217.74 provides the criteria (not

Federal Acquisition Regulation [FAR] 16.603-2, “Application”) for planning the definitization schedule for a letter contract.<sup>1</sup> DFARS Case 2008-D034 expanded the definition of “contract action” in DFARS 217.74 to include change orders and other un-priced modifications. Previously, change orders and other un-priced modifications adhered to guidance to the maximum extent practicable.

## **United States Air Force Space and Missile Systems Center**

The SMC mission is to “deliver unrivaled space and missile systems to the joint warfighter and our nation.” The Air Force Space Command Web site identified SMC as the center of technical excellence for researching, developing, and purchasing military space systems. SMC is also responsible for on-orbit, check-out testing, sustainment, and maintenance of military satellite constellations and other DoD space systems. SMC manages between \$50 and \$60 billion in contracts at any one time, with an annual budget in excess of \$6.8 billion.

### ***Wing Structure at SMC***

SMC is organized into wings by function. The wings depend on the Launch and Range Systems Wing to provide launch vehicles and related services. SMC wings are divided by function as listed by major contracting unit and program visited as follows:

- **Launch and Range Systems Wing** - Develops and acquires expendable launch and range systems and manages launch integration, mission assurance, and launch campaigns.
- **Space-Based Infrared Systems Wing** - Develops, acquires, and sustains space-based infrared surveillance, tracking, and targeting capabilities for missile early warning/defense and intelligence.
- **Military Satellite Communications Systems Wing** - Plans for, acquires, and sustains space-enabled, global communications capabilities to support national objectives.
- **Space Superiority Systems Wing** - Delivers and sustains space control systems to ensure space superiority for the joint warfighter and the nation.
- **Developmental Planning Directorate** - Constructively influences decisions affecting future systems for the control and exploitation of air and space.
- **Global Positioning Systems Wing** - Acquires and sustains survivable, effective, and affordable Global Positioning Systems services.

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<sup>1</sup> A letter contract is a written preliminary contractual instrument that allows a contractor to start work before the finalization of the contract terms.

## ***Evolved Expendable Launch Vehicle Program***

The President authorized a new national space policy on December 21, 2004, after the collapse of the commercial launch market to maintain critical skills and ensure United States access to space to fulfill national security requirements. The National Space Transportation Policy requires the Secretary of Defense to maintain two providers of launch vehicles supporting the Evolved Expendable Launch Vehicle (EELV) program. In 2005, the Government split the program into two efforts – expendable launch services involving hardware (rockets) and expendable launch capability involving support and maintenance. The two principal providers of launch vehicles and related services for the EELV program formed a joint venture in December 2006. SMC transferred the rights, duties, and terms from the existing contracts with the two principal providers to the joint venture through a novation agreement.<sup>2</sup>

## ***Space and Missile Systems Center UCA Usage (FY 2004–September 18, 2009)***

We selected a nonstatistical judgment sample<sup>3</sup> of 15 contracts that included 27 UCAs issued by SMC contracting personnel during FY 2004 through September 18, 2009, with a total UCA dollar value of about \$4.8 billion. We initially identified letter contracts through queries of the Federal Procurement Data System-Next Generation (FPDS-NG). We excluded letter contracts related to foreign military sales, congressionally mandated long lead procurements, or change orders after identifying UCAs in FPDS-NG. We then requested, and SMC contracting personnel provided, a list of UCAs issued from FY 2004 through September 18, 2009, from which we judgmentally selected additional UCAs. See Appendix C for a list of UCAs reviewed. Table 1 lists the number of contracts, the number of UCAs, and the total not-to-exceed dollar value of the UCAs that we reviewed.

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<sup>2</sup> With respect to Government contracts, a novation agreement is a legal instrument executed by the contractor (transferor), successor in interest (transferee), and Government, by which the transferor guarantees performance of the contract, the transferee assumes all obligations under the contract, and the Government recognizes the transfer of the contract and related assets.

<sup>3</sup> A nonstatistical judgmental sample does not generalize to universe; therefore, audit results should not be projected across all SMC UCAs.

**Table 1. Nonstatistical Judgment Sample of SMC UCAs by Wing  
FY 2004–September 18, 2009**

UCA Source	Number of Contracts	Number of UCAs	Not-to-Exceed Dollar Value
Launch and Range Systems Wing	6	11	\$2,136,665,850
Space-Based Infrared Systems Wing	2	4	2,117,900,000
Military Satellite Communications Wing	2	4	373,195,269
Space Superiority Systems Wing	1	2	90,946,950
Developmental Planning Directorate	1	2	30,500,000
Global Positioning Systems Wing	3	4	17,197,676
<b>Totals</b>	<b>15</b>	<b>27</b>	<b>\$4,766,405,745</b>

## **Review of Internal Controls at Air Force Space and Missile Systems Center**

DoD Instruction 5010.40, “Managers’ Internal Control Program (MICP) Procedures,” July 29, 2010, requires DoD organizations to implement a comprehensive system of internal controls that provides reasonable assurance that programs are operating as intended and to evaluate the effectiveness of the controls. We identified internal control weaknesses for SMC. SMC did not consistently manage UCAs. Specifically, internal control weaknesses allowed SMC contracting personnel to not definitize UCAs within allowable time frames and to inadequately document how costs incurred during the undefinitized period impacted the contractor’s profit. As a result, delays in definitizing contracts may have weakened SMC’s position in price negotiations and increased the cost to the Government. Additionally, SMC contracting personnel not adequately documenting allowable profit may have resulted in excess profit. Implementing Recommendations 1–5 in the Finding should improve SMC management of UCAs. We will provide a copy of the report to the senior official responsible for internal controls at Air Force Space and Missile Systems Center.



## **Finding. Inconsistent Management of Undefined Contractual Actions**

SMC personnel did not consistently comply with statutory and DoD requirements for managing 26 of 27 UCAs we reviewed. For the 26 UCAs, valued at \$4.7 billion, SMC personnel did not:

- prepare an adequate request for authorization to issue 1 UCA,
- definitize 18 UCAs within the 180-day time frame,
- reflect the contractor's reduced risk during the undefinitized period in negotiated profit for 3 UCAs,
- adequately support whether the reduced risk during the undefinitized period was reflected in profit on 11 UCAs, and
- obligate funds within allowable limits for 3 UCAs.

In addition, SMC contracting personnel improperly obligated the maximum permissible funding before definitization for 9 of 11 UCAs issued after August 2008. However, SMC contracting personnel adequately justified all 27 UCAs and adequately documented their determination of price reasonableness for 26 of the UCAs.

SMC contracting personnel issued a UCA with inadequate authorization because they did not fully explain the need to begin performance before definitization within the UCA authorization request. SMC contracting personnel were not able to definitize UCAs within allowable time frames because of multiple contributing factors that included contractors submitting inadequate proposals, changing Government requirements after SMC personnel issued the UCAs, and the complexity and size of the procurements. SMC contracting personnel negotiated a profit rate that did not reflect the reduced cost risk to the contractor during the undefinitized period because they determined that the weighted guidelines profit rate was inadequate for the contracted work. Further, SMC contracting personnel did not adequately support whether the reduced risk during the undefinitized period was reflected in profit because they prepared DD Forms 1547, "Record of Weighted Guidelines Application" and price negotiation memoranda (PNM) that did not provide sufficient detail that would allow an independent party to determine the basis for profit determination. SMC personnel obligated funds in excess of the allowable limits because they miscalculated the allowable obligation amount, they decreased the not-to-exceed value without adjusting the amount obligated, and they treated a UCA as a change order. Lastly, SMC contracting personnel obligated the maximum permissible funding before definitization because they did not take steps to implement the requirements of the August 2008 DPAP memorandum.

As a result, the SMC position in the price negotiation and contract award may have been weakened and delays in definitizing contracts may have increased the cost risk to the Government. Additionally, SMC personnel's failure to reflect the contractor's reduced risk during the undefinitized period in negotiated profit may have resulted in the Government paying more profit than was necessary.

## UCA Deficiencies

Our review of 27 UCAs issued by SMC contracting personnel identified a total of 45 deficiencies. UCA deficiencies consisted of six different types: inadequate authorization requests to issue a UCA, untimely definitization, failure to reflect contractor's reduced cost risk in negotiated profit, insufficient documentation of negotiated profit rate, obligating funds in excess of the allowable amounts, and obligating funds to the maximum allowable amount at issuance. See Appendix D for further details of the deficiencies. Table 2 identifies the reasons we considered the UCAs to be deficient.

**Table 2. Reasons UCAs Issued Were Deficient**

Deficiency Reason	Number of Instances*
Inadequate authorization request	1
Untimely contract definitization	18
Did not reflect the contractor's reduced risk during the undefinitized period in negotiated profit	3
Did not support whether the reduced risk during the undefinitized period was reflected in profit	11
Obligation of funds in excess of allowable amounts	3
Obligation to maximum allowable funding at UCA issue	9
<b>Total</b>	<b>45</b>

\*A UCA may have more than one deficiency.

## SMC Complied With Authorization Requirements

SMC contracting personnel obtained proper authorization before issuing UCAs for all 27 UCAs. However, for one UCA, SMC personnel prepared a request to issue a UCA that did not comply with statutory and DoD regulations to fully explain the need to begin performance before definitization. Both 10 U.S.C. § 2326 and the DFARS provide guidance on issuing UCAs. Section 2326(a), title 10, United States Code, states:

The head of an agency may not enter into an undefinitized contractual action unless the request to the head of the agency for authorization of the contractual action includes a description of the anticipated effect on requirements of the military department concerned if a delay is incurred for purposes of determining contractual terms, specifications, and price before performance is begun under the contractual action.

DFARS 217.7404-1, "Authorization," requires that the contracting officer obtain approval from the head of the contracting activity before entering into a UCA and also requires that the request for UCA approval include a full explanation of the need to begin contract performance before contract definitization. The head of the agency can delegate the approval to issue a UCA depending on the dollar value of the action.

SMC contracting personnel issued one UCA that did not adequately explain, as required by the DFARS, the need to begin performance before definitization within the authorization request to issue a UCA. The Under Secretary of the Air Force requested a review of the EELV Space Systems Acquisition Strategy before the initiation of new contracts in 2004. SMC contracting personnel issued letter contract FA8816-04-C-0001, with a not-to-exceed value of \$410,000, for the effort. SMC contracting personnel included the short completion time frame and 8-week period of performance in the authorization request to issue the letter contract, but did not specify why performance needed to begin before definitization. This single instance was not indicative of a larger problem with authorizing UCA usage; therefore, we are not making a recommendation on this issue.

## **SMC Lack of Compliance With Definitization Requirements**

SMC contracting personnel did not definitize 18 UCAs within the 180-day time frame specified by 10 U.S.C § 2326 and the DFARS. SMC contracting personnel were not able to definitize the 18 UCAs because of multiple contributing factors that included contractors submitting inadequate proposals, Government personnel changing contract requirements after SMC contracting personnel issued the UCA, and the complexity and size of the procurements. In addition, SMC contracting personnel were unable to definitize in a timely manner three of the four UCAs issued as a result of the formation of a joint venture by the two principal EELV providers.

Section 2326(b), title 10, United States Code, states:

A contracting officer of the Department of Defense may not enter into an undefinitized contractual action unless the contractual action provides for agreement upon contractual terms, specifications, and price by the earlier of—

(A) the end of the 180-day period beginning on the date on which the contractor submits a qualifying proposal to definitize the contractual terms, specifications, and price; or

(B) the date on which the amount of funds obligated under the contractual action is equal to more than 50 percent of the negotiated overall ceiling price for the contractual action.

Section 2326(g)(2) defines a “qualifying proposal” as:

. . . a proposal that contains sufficient information to enable the Department of Defense to conduct complete and meaningful audits of the information contained in the proposal and of any other information that the Department is entitled to review in connection with the contract, as determined by the contracting officer.

DFARS 217.7403, “Policy,” states that UCAs shall only be used when contracting officials cannot negotiate definitized contracts in sufficient time to meet the requirements of the Government. DFARS 217.7404-3, “Definitization schedule,” states:

UCAs shall contain definitization schedules that provide for definitization by the earlier of:

- (1) the date that is 180 days after issuance of the action (this date may be extended but may not exceed the date that is 180 days after the contractor submits a qualifying proposal), or
- (2) the date on which the amount of funds obligated under the contract action is equal to more than 50 percent of the not-to-exceed price.

DFARS 217.7404-3(b) further states that the contractor proposal submitted in accordance with the definitization schedule is a material element of the contract, and if the contractor does not submit a timely qualifying proposal, the contracting officer may suspend or reduce progress payments or take appropriate action.

Of the 27 UCAs reviewed, SMC personnel exceeded the time limits for 18 UCAs. See Appendix E for elapsed days between UCA issuance and definitization. On average, SMC contracting personnel averaged 335 days from UCA issuance to definitization for the 18 late actions. Additionally, for the 18 late actions, SMC contracting personnel took an average of 139 days to receive a qualifying proposal and 230 days to definitize the UCA after a qualifying proposal was received.

### ***Contributing Factors for Untimely Definitization***

SMC personnel were unable to definitize 18 of the 27 UCAs within required time frames. Table 3 shows the contributing factors for SMC contracting personnel not being able to definitize the 18 UCAs within the required time frames.

**Table 3. Contributing Factors for Late Definitization**

<b>Contract Number</b>	<b>Proposal Issues</b>	<b>Change in Government Requirement</b>	<b>Complexity &amp; Size of Program</b>	<b>Other<sup>1</sup></b>
FA8816-06-C-0002 P00055	√		√ <sup>2</sup>	√
FA8816-06-C-0002 P00121	√		√	√
FA8816-06-C-0002 P00124	√			
FA8807-08-C-0006				√
FA8807-05-C-0001 P00002	√		√	√
FA8808-06-C-0001		√	√	
FA8810-08-C-0002			√	√
FA8810-08-C-0002 P00002			√	√
FA8810-08-C-0002 P00007			√	√
FA8810-09-C-0002				√
FA8811-08-C-0005	√		√ <sup>2</sup>	√
FA8819-08-C-0006	√	√		√
FA8819-08-C-0006 P00002	√	√		√
FA8816-06-C-0001 P00011	√		√ <sup>2</sup>	√
FA8816-06-C-0004	√			
FA8816-06-C-0004 P00003	√		√	√
FA8816-06-C-0004 P00009	√			√
FA8816-06-C-0004 P00012		√		
<b>Totals</b>	<b>11</b>	<b>4</b>	<b>10</b>	<b>14</b>

<sup>1</sup> Other reasons included staffing shortages, truth in negotiations disclosure updates, prolonged contract negotiations, SMC disagreements over subcontracting plan, and SMC administrative delays.

<sup>2</sup> EELV Joint Venture

### ***Proposal Issues***

Contractors not submitting adequate proposals in a timely manner contributed to 11 late definitizations. The contractor proposals were inadequate because the contracting officer determined that they did not contain sufficient information to enable DoD personnel to conduct complete and meaningful audits of the information contained in the proposal, or the contracting officer determined the proposals contained questionable costs. Prime contractors' use of multiple subcontractors and proposal resubmissions also added time to the undefinitized period. Contractor resubmissions often required that the Defense Contract Audit Agency (DCAA) perform additional audit work and SMC personnel to perform additional technical reviews. If DoD personnel determine that the revised proposal is inadequate then the revision process starts again. SMC should develop a metric for measuring contractor responsiveness to requests to preparing qualifying proposals. The following four UCAs are examples of how problems with inadequate proposals contributed to delays in definitization. In addition to the four examples, SMC personnel identified proposal issues as a contributing factor for the untimely definitizations of seven other UCAs.

### **Contract FA8811-08-C-0005**

SMC contracting personnel were unable to definitize contract FA8811-08-C-0005, with a not-to-exceed value of \$505.3 million, within required time frames. SMC contracting personnel awarded the contract on January 24, 2008, for launch vehicle services for three missions. The delay in definitization resulted when DCAA determined the contractor's initial proposal to be an inadequate basis for negotiation of a fair and reasonable price. SMC officials required the contractor to revise its original proposal to include a consolidated bill of materials. The contractor did not submit the second revision until November 20, 2008, because it had problems revising its proposal. SMC contracting personnel and DCAA discovered multiple inadequacies in the second proposal, and the contractor withdrew the proposal. The contractor submitted a third proposal that included an addendum for a fourth mission. Contract FA8811-08-C-0005 could not be definitized in time to ensure the lead-time required for the fourth mission would be available and because the mission was outside the scope of the UCA. The fourth mission was subsequently awarded under a separate contract. DCAA submitted a report on all four of the missions on April 14, 2009, and questioned 13 percent of the proposed costs. DCAA considered the proposal an unacceptable basis for negotiation of a fair and reasonable price based on significant proposal noncompliance and inadequacies. SMC contracting personnel did not receive a qualifying proposal until 361 days after issuing the UCA and were unable to definitize the contract until 571 days after issuing the UCA.

### **Contract FA8816-06-C-0002, Modification P00124**

SMC contracting personnel were unable to definitize contract FA8816-06-C-0002, modification P00124, with a not-to-exceed value of \$15 million, within required time frames. SMC contracting personnel awarded the UCA on January 16, 2009, for revisions to the annual launch rate capability on the Atlas V EELV Launch Capability contract to allow the contractor to sustain a 5-per-year launch rate capability. DCAA determined that the initial proposal received from the contractor was inadequate. The contractor updated the proposal three times: once in response to the adverse DCAA audit, once to include actual costs-to-date plus an estimate to complete, and once to add 5 weeks of effort that were not included in the second update. As a result, SMC contracting personnel did not receive a qualifying proposal until 244 days after the UCA was issued. SMC contracting personnel definitized the contract 13 days later.

### **Contract FA8816-06-C-0004, Modification P00009**

SMC contracting personnel were unable to definitize contract FA8816-06-C-0004, modification P00009, with a not-to-exceed value of \$95.7 million, within the required time frames. SMC contracting officials awarded the UCA on December 19, 2008, for the National Reconnaissance Office Launch 41 Launch Order and to allow the contractor to commence work associated with Mission National Reconnaissance Office Launch 41 Launch Services. DCAA received a revised proposal and anticipated completion of its audit by February 27, 2009. In February 2009, DCAA was unable to obtain contractor records, requested additional time, and in April 2009, requested the contractor to provide updated cost and pricing data. DCAA completed the audit on April 8, 2009, and determined that the contractor's proposal disclosed significant issues



and limitations that impacted the acceptability of the proposal for negotiation of a fair and reasonable price. As a result of the proposal problems, SMC contracting personnel were unable to definitize the UCA until 261 days after receiving a qualifying proposal.

### **Contract FA8819-08-C-0006**

SMC contracting personnel were unable to definitize contract FA8819-08-C-0006, with a not-to-exceed value of \$35.3 million, within the required time frames. SMC contracting personnel awarded the contract on June 24, 2008, for Space-Based Space Surveillance Block 10 Maintenance and Operations Requirements startup activities, to include development of plans, logistics support, involvement in training and rehearsal activities, and procurement of necessary hardware and other depot maintenance activities. SMC contracting personnel were unable to definitize the pre-planning activities in a timely manner due to a series of events including proposal inconsistencies, requirements changes, launch delays, and delayed DCAA audits. According to the contracting officer, the UCA exceeded the 180-day limitation because of launch delays and the contractor submitting multiple proposals in response to changes in the Air Force requirement. As a result of proposal problems and other contributing factors, SMC contracting personnel were unable to definitize the UCA until 357 days after receipt of a qualifying proposal and 478 days after issuing the UCA.

### ***Changes in Government Requirements***

SMC contracting personnel were unable to definitize four UCAs within the 180-day requirement; in part because program office personnel changed requirements after SMC contracting personnel issued the UCA. After issuing a UCA, contracting personnel have little control over changing customer requirements. Each significant change in requirements requires the contractor to prepare or revise a proposal that contracting personnel must then review. SMC contracting and program office personnel should better coordinate with customers and management to identify changes in Government requirements as soon as practicable and document changes in the acquisition narrative. In addition to the following two examples, SMC contracting personnel identified changes in Government requirements as a contributing factor for one other UCA. SMC contracting personnel were unable to definitize the following UCAs within the 180-day requirement.

### **Contract FA8819-08-C-0006, Modification P00002**

SMC contracting personnel were unable to definitize contract FA8819-08-C-0006, modification P00002, with a not-to-exceed value of \$55.6 million, within the required time frames. SMC contracting personnel awarded the UCA on December 22, 2008, for the Space-Based Space Surveillance Block 10 Maintenance and Operations Requirements. The contractor submitted a series of proposals to the Government. SMC personnel stated in the PNM that the proposal submissions and revisions were caused by changes to the Government's requirements, proposal ambiguities, disconnects between contractor and Government understanding of requirements, and audit delays. The contractor submitted six proposal updates and revisions post-audit that addressed changes in the methodology, changes in launch dates, proposal inconsistencies, and rate updates.

SMC contracting personnel took 388 days to definitize the UCA after issuance because of changes in Government requirements and proposal problems.

### **Contract FA8808-06-C-0001**

SMC contracting personnel were unable to definitize contract FA8808-06-C-0001, with a not-to-exceed value of about \$148.2 million, within the required time frames. SMC contracting personnel awarded the UCA on February 17, 2006, for Wideband Gapfiller Satellite 4 advance procurement and nonrecurring engineering. SMC requested that the contractor update the proposal to include six over-and-above scope efforts during the undefinitized period. SMC contracting personnel took 4 months to negotiate the UCA because the contractor proposed a 100/0 share ratio to bridge a \$20 million gap between the Government and contractor's target cost position. SMC contracting personnel took 242 days to definitize the UCA after issuance because of changes in Government requirements and prolonged negotiations.

### ***Impact of Size and Complexity on Definitization***

The size and the complexity of the UCA contributed to the time necessary to definitize 10 of the UCAs that we reviewed. SMC contracting personnel took less time to definitize UCAs with lower not-to-exceed values and more time to definitize complex UCAs with higher not-to-exceed values for the UCAs. For the UCAs that we reviewed with the six lowest and six highest not-to-exceed values, SMC personnel required more time to definitize the UCAs with higher dollar values because of the complexity and size of the programs. SMC contracting personnel execute procurements that require labor- and time-intensive technical reviews and require DCAA advisory audits that impact the definitization time frames. In addition, contractors take additional preparation time for complex proposals, and SMC contracting personnel take more time to negotiate definitive contracts.

### **Attributes of the UCAs with the Six Lowest Not-to-Exceed Values**

SMC personnel were generally able to definitize UCAs with lower not-to-exceed values in shorter time frames; however, three of the six UCAs with the lowest not-to-exceed values took longer than 197 days from issuance to definitization. The average not-to-exceed value of the six UCAs with the lowest not-to-exceed values was \$3.4 million. SMC contracting personnel were able to definitize UCAs with lower not-to-exceed values in shorter time frames because the programs were smaller, the number of subcontractors was lower, and DCAA proposal audits were completed in shorter time frames. Table 4 shows the UCAs with the six lowest not-to-exceed values.

**Table 4. Definitization Time Frames for the Six Lowest Dollar Value Actions**

<b>Contract Number</b>	<b>Not-to-Exceed</b>	<b>Days from Issuance to Qualifying Proposal</b>	<b>Days from Qualifying Proposal to Definitization</b>	<b>Days from Issuance to Definitization</b>
FA8807-05-C-0001	\$121,377	69	42	111
FA8816-04-C-0001	\$410,000	43	78	121
FA8816-06-C-0004	\$3,000,000	47	198	245
FA8807-08-C-0006	\$4,311,299	NA <sup>2</sup>	NA <sup>2</sup>	197
FA8807-07-C-0005	\$6,000,000	128	123	251
FA8807-05-C-0001 P00002	\$6,765,000	247	42	289
<b>Averages</b>	\$3,434,613	107	97	202
<b>Average For All 23 UCAs</b>	\$132 million <sup>1</sup>	97	168	268

<sup>1</sup>Does not include four actions related to the formation of the joint venture by the two principal contractors for the EELV program.

<sup>2</sup>Qualifying proposal received before UCA issuance.

### **Attributes of the UCAs With the Six Highest Not-to-Exceed Values**

SMC UCAs with the six highest not-to-exceed values were all definitized after the allowable time frames. The six highest dollar value UCAs had an average not-to-exceed value of \$418.7 million and took an average of 377 days to definitize from issuance. The extended definitization time frames were attributable to the size and complexity of the programs and services procured. UCAs for higher dollar procurements require labor- and time-intensive DCAA proposal audits. Additionally, prime contractors on larger programs often work with more subcontractors, and accumulating data from multiple subcontractors can require additional time for proposal preparation. We excluded four UCAs related to the formation of the joint venture by the two prime EELV providers because the event was extraordinary and would have increased the number of days to definitize a UCA and distorted the overall results. Table 5 shows the UCAs with the six highest not-to-exceed values. Contract FA8810-08-C-002, modification P00002 is an example of how the size and complexity of the action impacted the time necessary to definitize.

**Table 5. Definitization Time Frames for the Six Highest Dollar Value Actions**

<b>Contract Number</b>	<b>Not-to-Exceed</b>	<b>Days from Issuance to Qualifying Proposal</b>	<b>Days from Qualifying Proposal to Definitization</b>	<b>Days from Issuance to Definitization</b>
FA8816-06-C-0004 P00003	\$119,000,000	NA <sup>2</sup>	NA <sup>2</sup>	258
FA8816-06-C-0004-P00012	\$145,200,000	20	656	676
FA8808-06-C0001	\$148,195,269	NA <sup>2</sup>	NA <sup>2</sup>	242
FA8810-08-C-0002 P00007	\$262,500,000	NA <sup>2</sup>	NA <sup>2</sup>	328
FA8810-08-C-0002	\$350,000,000	252	138	390
FA8810-08-C-0002 P00002	\$1,487,400,000	NA <sup>2</sup>	NA <sup>2</sup>	370
<b>Averages</b>	\$418,715,878	136	397	377
<b>Average For All 23 UCAs</b>	\$132 million <sup>1</sup>	97	168	268

<sup>1</sup>Does not include four actions related to the formation of the joint venture by the two principal contractors for the EELV program.

<sup>2</sup> Qualifying proposal received before UCA issuance.

### **Example of High Dollar Value Complex Definitization**

SMC contracting personnel were unable to definitize contract FA8810-08-C-0002, modification P00002, with a not-to-exceed value of about \$1.5 billion, within the required time frames. SMC contracting personnel awarded the UCA on May 29, 2009, for the production of the third Geosynchronous Earth Orbit Satellite, production of the Highly Elliptical Orbit Payload, and modification of the Space-Based Infrared Ground System. SMC contracting personnel received a qualifying proposal before issuing the UCA, but the technical evaluation of the proposal took 191 days and over 50 SMC personnel to complete. Additionally, DCAA took 214 days to complete the proposal review, and contract negotiations took 96 days before the contract was definitized. SMC contracting personnel took 370 days to definitize the UCA because of the complexity and size of the effort, prolonged negotiations, and lengthy time frames for technical and DCAA reviews.

### **Contracts Affected by Joint Venture Formation**

SMC contracting personnel were unable to definitize in a timely manner three of the four UCAs issued as a result of the formation of a joint venture by the two principal EELV providers. SMC personnel experienced delays in definitizing the UCAs because of issues that arose during the formation process. The joint venture submitted proposals using the forward pricing rate agreements of the original EELV providers. The joint venture, as part of the formation agreement, assured the Government of cost efficiencies and savings as a result of the formation. SMC contracting personnel were unable to definitize three of the four UCAs related to the formation of the joint venture because the Defense Contract Management Agency took 7 months to establish forward pricing rate agreements, the joint venture frequently updated and revised proposals, and negotiations were prolonged because of contract size and complexity. Additionally, DCAA had to complete complex and time-intensive proposal reviews for the joint venture that added

additional complications and definitization delays. SMC personnel received a qualifying proposal before issuing the UCAs for 3 of the 4 actions and took an average of 320 days from issuance to definitization for the 4 actions. The four UCAs accounted for \$1.7 billion, or about 36 percent, of the total not-to-exceed value of the 27 UCAs reviewed. The following three UCAs are examples of how the formation of the joint venture contributed to the time necessary for SMC contracting personnel to definitize the four UCAs.

### **Contract FA8816-06-C-0002, Modification P00055 and Contract FA8816-06-C-0001, Modification P00011**

SMC contracting personnel were unable to definitize two similar UCAs issued to the two principal EELV providers on contracts FA8816-06-C-0002, modification P00055, with a not-to-exceed value of about \$459 million, and FA8816-06-C-0001, modification P00011, with a not-to-exceed value of about \$583 million. SMC contracting personnel issued the UCAs to maintain critical skills and support infrastructure- and noninfrastructure-related activities for the EELV program. SMC contracting personnel issued both UCAs in October 2007. SMC contracting personnel experienced delays in definitizing the UCAs because the Defense Contract Management Agency took 7 months to establish forward pricing rate agreements for the joint venture. Additionally, DCAA determined proposals submitted by the joint venture to be inadequate because they relied upon forward pricing rate agreements from the original EELV providers. As a result, the joint venture updated its proposal numerous times during the undefinitized period. SMC contracting personnel took nearly 3 months to negotiate definitized contracts because of the size and complexity of the UCAs. In total, the UCAs remained undefinitized for 269 days for FA8816-06-C-0002 and 305 days for FA8816-06-C-0001.

### **Contract FA8811-08-C-0005**

SMC contracting personnel were unable to definitize contract FA8811-08-C-0005, with a not-to-exceed value of \$505.3 million, within required time frames. SMC contracting personnel issued the UCA on January 24, 2008, to preserve the launch dates for three missions of an EELV contract. SMC contracting personnel experienced delays in definitizing the contract because the joint venture submitted four proposals that DCAA determined to be inadequate for negotiating a fair and reasonable price. As a result of problems with the joint venture's proposal, which included revisions due to changes in accounting systems and policies, SMC contracting personnel did not receive a qualifying proposal until 361 days after the UCA was issued, and SMC contracting personnel definitized the UCA 210 days after receiving a qualifying proposal. The UCA was undefinitized for a total of 571 days.

### ***Other Impacts on Definitization Time Frames***

SMC contracting personnel were unable to definitize UCAs in a timely manner and cited issues with inexperienced contractors, staff unavailability, prolonged negotiation time frames, launch delays, and staff shortages. In addition to the three following examples, SMC contracting personnel identified 12 instances in which other factors delayed definitization in combination to proposal problems, changes in

Government requirements, and the size and complexity of UCAs. Of the 15 instances, 3 related to the formation of the joint venture by the two principal EELV providers.

### **Contract FA8807-05-C-0001, Modification P00002**

SMC contracting personnel were unable to definitize contract FA8807-05-C-0001, modification P00002, with a not-to-exceed value of about \$6.8 million, within the required time frames. SMC contracting personnel awarded the UCA on September 14, 2005, for phase 2 of the Rubidium Atomic Frequency Standard Modification program. SMC contracting personnel received a qualifying proposal 247 days after issuing the UCA because the contractor was inexperienced with the proposal process. Additionally, the contractor made assumptions about Government-furnished property that resulted in a 2-month delay and a revised not-to-exceed value.

### **Contract FA8816-06-C-0002, Modification P00121**

SMC contracting personnel were unable to definitize contract FA8816-06-C-0002, modification P00121, with a not-to-exceed value of \$27.5 million, within the required time frames. SMC contracting personnel awarded the UCA on November 6, 2008, for the acquisition of EELV Launch Capabilities Mission-Unique integration and Mission-Unique Non-Flight Hardware and a Geo-Synchronous Orbit Kit. SMC contracting personnel received a qualifying proposal the day after the UCA was issued and completed fact finding efforts over a 3-month period because of staff unavailability and the complexity of the proposal. Additionally, after SMC personnel had completed technical evaluations of the contractor's proposal, disclosure updates materially impacted prices and the technical evaluations had to be revised causing the UCA to be definitized 220 days after SMC personnel received the qualifying proposal.

### **Contract FA8810-08-C-0002**

SMC contracting personnel were unable to definitize contract FA8810-08-C-0002, with a not-to-exceed value of \$350 million, within required time frames. SMC contracting personnel awarded the UCA on March 14, 2008, for long-lead supplies and services for the production of Geosynchronous Earth Orbit Satellite number three and Highly Elliptical Orbit Payload number three. SMC contracting personnel did not receive a qualifying proposal from the contractor for 252 days because of extensive pre-coordination shoulder-to-shoulder activity between the SMC contracting personnel and the contractor. SMC contracting personnel held the pre-coordination meetings to clarify objectives and understandings before formal proposal submission because of parts obsolescence and known deficiencies with the production of earlier portions of the acquisition. As a result, SMC contracting personnel took 390 days to definitize the UCA.

## **SMC Compliance With Requirements to Reflect the Undefinitized Period on Allowable Profit**

SMC contracting personnel issued 3 UCAs that did not reflect the reduced cost risk to the contractor in the negotiated profit during the undefinitized period and issued 11 UCAs that did not include sufficient support that would allow an independent party to determine the basis for their profit determination. SMC contracting personnel were required to use



a weighted guidelines method to develop a profit objective for 18 of the UCAs.<sup>4</sup> SMC contracting personnel used a Web-based tool to apply the weighted guidelines method for 16 of the UCAs. However, the Web-based tool's output, DD Form 1547, "Record of Weighted Guidelines Application," was inadequate as sole support for profit determination because it did not clearly document how the undefinitized period was reflected in the contractor's profit or fee. The DD Form 1547 was inadequate because it did not clearly document the:

- degree to which costs were incurred before definitization,
- risk factors assigned to the incurred cost and projected cost when the weighted guidelines application was used, and
- resulting impact on the contractor's profit or fee.

In addition, SMC contracting personnel's discussions on profit determination in the PNMs were insufficient to adequately document the degree to which costs were incurred before definitization or did not contain adequate documentation that supported how the undefinitized period was reflected in the contractor's profit or fee for 11 UCAs. During the undefinitized period, the Government bears increased risk, and the contractor generally bears reduced risk. If the contractor's reduced risk is not reflected in the negotiated profit rate, then the Government could be paying too much profit to the contractor.

### ***Requirements to Reflect Reduced Cost Risk in the Contractor's Profit or Fee***

Both 10 U.S.C. 2326 and the DFARS provide guidance on profit determination, and the FAR provides guidance on documentation of the price negotiation. Section 2326(e), title 10, United States Code, states:

The head of an agency shall ensure that the profit allowed on an undefinitized contractual action for which the final price is negotiated after a substantial portion of the performance required is completed reflects—

- (1) the possible reduced cost risk of the contractor with respect to costs incurred during performance of the contract before the final price is negotiated; and
- (2) the reduced cost risk of the contractor with respect to costs incurred during performance of the remaining portion of the contract.

DFARS 215.404-4, "Profit," requires that contracting officers use a structured approach for developing a pre-negotiation profit or fee objective on any negotiated contract action

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<sup>4</sup> Eight of the UCAs were exempt from the requirement to reflect the contractor's possible reduced cost risk in the allowable profit because the contract type was cost-plus-award-fee (6) and the not-to-exceed value of the UCA was below the threshold for obtaining cost or pricing data (2), therefore, use of the weighted guidelines was not required. One UCA was definitized on September 13, 2010, but SMC personnel did not provide a completed price negotiation memorandum to the audit team so a full analysis could not be completed.

when the contractor provides cost or pricing data, except for cost-plus-award-fee contracts or contracts with Federally Funded Research and Development Centers. DFARS 215.404-4 further states that the weighted guidelines method is the structured approach that must be used, with certain limited exceptions. FAR 15.406-3, “Documenting the Negotiation,” states that the PNM is the required document in which the contracting officer must document the basis for the profit or fee prenegotiation objective and the profit or fee negotiated.

### ***Reduced Risk Not Reflected in Government’s Negotiation Position***

SMC contracting personnel did not comply with the requirement in 10 U.S.C. 2326(e) to reflect the undefinitized period in the contractor’s profit or fee because they relied on guidance with a lower precedent when developing the Government’s negotiation position. SMC contracting personnel issued three UCAs on contract FA8808-04-C-0022, each with a not-to-exceed of \$75 million, to extend the period of performance for the Transformational Communications Satellite Risk Reduction Systems Definition effort by 6 months. SMC personnel did not reflect the impact of the undefinitized period on the contractor’s profit or fee because they used FAR 15.404-4(c)(6), “Profit,” which permits contracting officers to use the basic contract’s profit or fee rate as the prenegotiation objective for a change or modification to a contract if the change or modification calls for essentially the same type and mix of work as the basic contract and is of relatively small dollar value compared to the total contract value. SMC contracting personnel considered the reduced cost risk when using the weighted guidelines to develop the Government’s objective profit rates for the UCAs; however, they used profit rates that were higher than those generated by the weighted guidelines tool as a basis to begin negotiations.

SMC contracting personnel documented in the PNM for each of the three UCAs that the profit rate objective generated by the weighted guidelines was insufficient to stimulate efficient contract performance and to attract the best talent required for the highly complex technical effort. SMC contracting personnel used these factors to justify a profit rate that was higher than the weighted guidelines rate but did not reflect how the UCA impacted the Government’s profit position at negotiation. SMC contracting personnel’s use of a higher profit rate did not appropriately consider that the majority of the work had been completed before definitization. Additionally, SMC contracting personnel noted that the action was of relatively small dollar value to the total contract. However, each UCA represented a \$75 million continuation of a program into which the Government had already invested \$514 million. As a result, SMC contracting personnel entered into negotiations with profit positions that did not reflect the contractor’s reduced risk during the undefinitized period as indicated by the weighted guidelines. The Government’s negotiation position on profit was higher than if the weighted guidelines had been used. SMC should develop procedures to ensure that the Government’s position at UCA

definitization reflects reduced contract type risk. Table 6 shows the profit rate if the weighted guidelines had been used, the actual amount of profit that was paid to the contractor for each of the UCAs, and the difference.

**Table 6. Comparison of Objective Profit Using Weighted Guidelines Rate and Actual Profit Paid**

<b>Modification Number</b>	<b>Total Costs Excluding Cost of Money</b>	<b>Weighted Guidelines Rate</b>	<b>Profit Using Weighted Guidelines Rate</b>	<b>Actual Profit Paid (~10%)</b>	<b>Difference</b>
P00043	\$67,759,434	6.5%	\$4,404,363	\$6,775,944	\$2,371,581
P00046	67,742,055	6.72%	4,552,266	6,774,204	2,221,938
P00052	67,560,548	7.44%	5,026,504	6,719,454	1,692,950
<b>Totals</b>	<b>\$203,062,037</b>		<b>\$13,983,133</b>	<b>\$20,269,602</b>	<b>\$6,286,469</b>

### ***DD Form 1547 Provided Inadequate Support of Profit Determination***

SMC contracting personnel used DD Form 1547, which was generated by the weighted guidelines application, as sole support for the profit determination for 11 of the 18 UCAs that required the use of the weighted guidelines method to develop the profit objective. However, the form did not provide sufficient detail as sole support that the undefinitized period was a consideration in profit determination. The weighted guideline tool took into consideration incurred cost, the undefinitized period, and the remaining portion of the contract to develop a profit objective. The contracting officer entered the incurred and projected costs into the application and assigned values to the contract risk factors. The application then produced a composite contract type risk factor. The weighted guidelines application then generated a total profit objective for the contract based on the factors entered by the contracting officer and the composite contract type risk factor generated by the application. The contracting officer should have used the profit objective as the Government's basis for negotiations with the contractor.

However, DD Form 1547 did not display all of the factors entered by the contracting officer. The form identified a profit factor but did not state the degree to which costs were incurred before definitization, the risk factors assigned to the incurred cost and projected cost, or the resulting impact on the contractor's profit or fee. As a result, it was not possible for an independent party to determine how the contracting officer considered the contractor's possible reduced cost risk unless the contracting officer documented the risk assessment in the contract file. Contracting personnel should document the costs incurred before definitization and their impact on profit determination in the PNM. Both

the GAO and DoD IG recommended in previous reports that DoD revise the DFARS to include instructions on how to perform an assessment of any reduced cost risk on profit or fee during the undefinitized period.<sup>5</sup>

### ***Inadequate Documentation of Profit Determination in the PNM***

SMC contracting personnel did not adequately document the profit determination in the PNM for 11 of the 18 UCAs that we reviewed. SMC personnel did not include the costs incurred before definitization for 5 of the 11 UCAs. Of the remaining 6 UCAs in which the PNMs included the cost incurred before definitization, we were unable to determine the effect that the incurred costs had on the contractor's profit because the profit determination was only supported by the DD Form 1547. The DD Form 1547, as the sole documentation for the profit determination, did not provide sufficient detail for us to determine the effect of the incurred costs on profit. DFARS 215.404-71-3 requires contracting officers to assess the extent to which costs have been incurred prior to definitization, and to regard the contract type risk to be in the low end of the designated range when costs have been incurred prior to definitization. The contract type risk factor focuses on the degree of cost risk accepted by the contractor under varying contract types. Contracting officers must assign a value for contract type risk and input the value into box 24 of the DD Form 1547 when using the weighted guidelines tool. Although the contracting officers may have documented the cost incurred during the undefinitized period and used the weighted guidelines application to develop a profit objective, they did not consistently document the resulting effect on the contractor's allowable profit. Without adequate discussion of the contracting officer's consideration of the cost incurred, we were unable to determine to what extent the undefinitized period was reflected in the contractor's profit. SMC officials should revise the *SMC Buyer's Handbook*, November 19, 2009, to include requirements to document incurred costs, their effect on the profit/fee analysis, and a discussion about the inputs used for box 24 of the DD Form 1547.

### ***Adequate and Inadequate Documentation of Profit Determination in the PNM***

We reviewed the PNM for each of the 18 UCAs that were required to undergo a weighted guidelines analysis to determine whether the contracting officer's consideration of the undefinitized period and its effect on the contractor's profit was adequately documented. The following two UCAs are examples of adequate and inadequate documentation of profit determination.

#### **Contract FA8819-08-C-0006, Modification P00002**

SMC contracting personnel prepared the PNM for contract FA8819-08-C-0006, modification P00002 that adequately documented the contracting officer's consideration of the undefinitized period and its effect on the contractor's profit. We

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<sup>5</sup> GAO Report No. GAO-10-299, "DoD Has Enhanced Insight into Undefinitized Contract Action Use, but Management at Local Commands Needs Improvements," January 28, 2010, and DoD IG Report No. D-2004-112, "Undefinitized Contractual Actions," August 30, 2004.

considered the documentation to be adequate because contracting personnel properly explained the amount of costs incurred before definitization and their effect on the contract type risk used in the weighted guidelines application, the reasons the assigned risk factors were either normal or deviated from the normal values, and the profit objective generated based on the incurred cost and risk factors. Specifically, SMC contracting personnel stated in the PNM that the contract type risk used in the weighted guidelines application was reduced because two-thirds of the actual cost had been incurred before definitization, and the technical and management risk factors assigned were normal. Also, because the Government's profit objective was sustained in negotiations, it can clearly be seen how the undefinitized period was reflected in the contractor's profit.

### **Contract FA8816-06-C-0004, Modification P00009**

SMC contracting personnel prepared the PNM for contract FA8816-06-C-0004, modification P00009 that did not adequately document the contracting officer's consideration of the undefinitized period and its effect on the contractor's profit. We considered the documentation to be inadequate for several reasons. First, contracting personnel included a statement that the Government used the weighted guidelines, but they did not provide details about the amount of costs incurred before definitization or provide any indication of costs incurred. Also, SMC contracting personnel did not state the effect of the incurred cost and the use of the weighted guidelines application on the contractor's profit in the PNM. Finally, SMC contracting personnel stated the objective rate that was generated by using the weighted guidelines tool in the PNM, but also stated that a higher rate was used. Because SMC contracting personnel did not use the objective rate, it cannot clearly be seen how the undefinitized period was reflected in the contractor's profit. SMC management should revise the *SMC Buyer's Handbook* to include instructions on documenting in the profit section of the PNM how the undefinitized period impacts the contractor's profit or fee and the inputs made to the contract type risk of the DD Form 1547.

### ***Revised Requirement***

In June 2007, GAO issued Report No. GAO-07-559, "Defense Contracting: Use of Undefinitized Contract Actions Understated and Definitization Time Frames Often Not Met," which criticized DoD for inadequately documenting the impact of costs incurred before definitization on profit and fee rates. In response to the report, the Director, Defense Procurement, Acquisition Policy, and Strategic Sourcing, issued the August 2008 DPAP memorandum that provided guidance to contracting officers regarding the requirements contained in DFARS 215.404-71, which advocates the lowering of contract type risk based on the amount of costs incurred before definitization. The memorandum required contracting officers to document the risk assessment in the contract file. See Appendix B for a copy of the memorandum. Twelve of the 18 UCAs that we reviewed for profit determination were definitized after the August 2008 DPAP memorandum. Seven of the 12 UCAs were in compliance with the August 2008 DPAP memorandum requirement to document the risk assessment in the contract file, and 5 were not in compliance.

## SMC Compliance With Obligation Limitations

SMC contracting personnel exceeded the limitations for obligating funds on UCAs for 3 of the 27 UCAs. Contracting officers are limited by 10 U.S.C. § 2326 in the amount of funds they may obligate on a UCA to 50 percent of the not-to-exceed value before receipt of a qualifying proposal and to 75 percent after receipt of a qualifying proposal. Exceeding the allowable obligation thresholds puts the Government in a poor position to negotiate a contract at definitization because contractors are less inclined to submit a qualifying proposal when there is adequate funding available to continue the work.

Section 2326(b)(2) and (3), title 10, United States Code, states:

(2) Except as provided in paragraph (3), the contracting officer for an undefinitized contractual action may not obligate with respect to such contractual action an amount that is equal to more than 50 percent of the negotiated overall ceiling price until the contractual terms, specifications, and price are definitized for such contractual action.

(3) If a contractor submits a qualifying proposal (as defined in subsection (g)) to definitize an undefinitized contractual action before an amount equal to more than 50 percent of the negotiated overall ceiling price is obligated on such action, the contracting officer for such action may not obligate with respect to such contractual action an amount that is equal to more than 75 percent of the negotiated overall ceiling price until the contractual terms, specifications, and price are definitized for such contractual action.

SMC contracting personnel obligated funds in excess of allowable amounts for three UCAs because they miscalculated the allowable obligation amount, they reduced the not-to-exceed value without decreasing the amount obligated, and they treated a UCA as a change order. SMC contracting personnel inappropriately obligated 75.6 percent of the not-to-exceed value before definitization for contract FA8808-06-C-0001. Contracting personnel's changes to the not-to-exceed value resulted in the obligation value exceeding the allowable thresholds.

SMC contracting personnel inappropriately obligated more than 75 percent of the not-to-exceed value before definitizing the UCA for contract FA8819-08-C-0006. SMC contracting personnel issued modification P00002 to extend the contract period of performance. SMC contracting personnel decreased the not-to-exceed value without a corresponding decrease in the obligation amount, which raised the obligated value to 86 percent of the not-to-exceed value. Neither of these instances was indicative of a SMC-wide problem with the obligation of funding for UCAs; therefore, we are not making a recommendation on this issue. SMC contracting personnel obligated 100 percent of the not-to-exceed value at issuance and before receipt of a qualifying proposal for contract FA8816-06-C-0004. Contracting personnel stated that the UCA was a change order and not a UCA and was not subject to the funding limitation. The contract documentation for contract FA8816-06-C-0004 was conflicting as to whether the action was a UCA or a change order. See the Change Order section on page 28 of the report for a discussion of the treatment of UCAs and change orders at SMC.

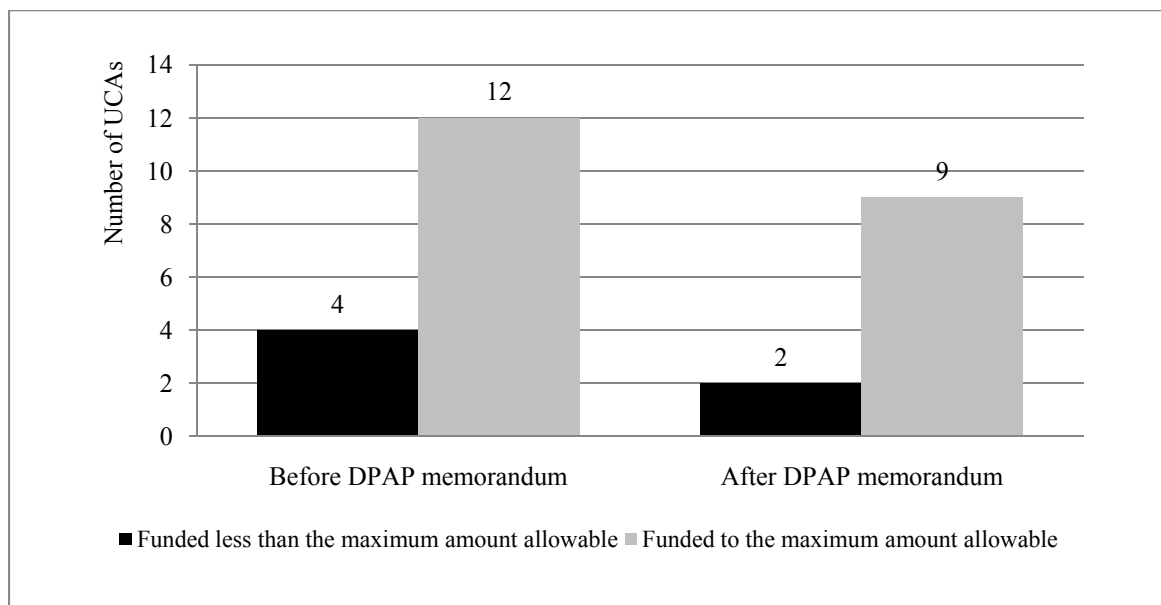


## Obligating Funds as Needed

SMC contracting personnel obligated the maximum permissible funding before definitization for 21 of 27 UCAs. The August 2008 DPAP memorandum instructed contracting officers to assess the contractor's spend plan for the undefinitized period and obligate funding in an amount consistent with the contractor's requirements for the undefinitized period. Further, contracting officers should avoid obligating the maximum allowable funding amount at the time of UCA award to discourage extended periods of performance before definitization. Contracting officers funding UCAs according to anticipated contractor expenditures can aid in timely contract definitization.

SMC contracting personnel had not taken steps to comply with the August 2008 DPAP memorandum requirement to avoid obligating the maximum permissible funding at contract award. Both before and after DPAP issued the memorandum, SMC contracting personnel commonly funded UCAs to the maximum amount allowable. SMC contracting personnel obligated funds for more than the maximum amount allowable for 12 of the 16 UCAs from our nonstatistical judgment sample that were issued before the August 2008 DPAP memorandum and for 9 of the 11 UCAs that were issued after the DPAP memorandum. The contracting officer can strengthen the Government's negotiation position by limiting funding to incremental amounts to help obtain a timely definitization. SMC contracting personnel should take steps to comply with the August 2008 DPAP memorandum requirement by obligating funding according to the contractor's requirements rather than to the maximum amount permissible. The Figure shows the number of UCAs obligated at the maximum amounts at issuance before and after the August 2008 DPAP memorandum.

**Figure. UCAs Obligated at Maximum Allowable Amounts Before Definitization Before and After the August 2008 DPAP Memorandum**



## Justification for Issuing UCAs

SMC personnel prepared requests to issue UCAs that included justifications that complied with DFARS requirements for all 27 UCAs. DFARS 217.7403, “Policy,” limits the use of a UCA to situations when negotiating a definitive contract is not possible and the Government’s interest demands contract performance begin immediately. SMC personnel primarily cited missed launch dates or delayed payload delivery dates as adverse impacts if SMC personnel did not issue a UCA. They also cited a loss of experienced personnel and project continuity as potential adverse impacts. SMC contracting personnel identified several reasons for the need for urgency. We identified, as illustrated in Table 7, the reasons SMC used UCAs.

**Table 7. Reasons for SMC UCA Use**

<b>Reasons for UCA Issuance</b>	<b>Number of UCAs</b>	<b>Not-to-Exceed Dollar Value</b>	<b>Percent of Total Not-to-Exceed</b>
Multiple, Inseparable Issues	5	\$2,272,600,000	47.68
Formation of Joint Venture	4	1,730,855,850	36.31
Budget Reduction Issues	3	262,195,269	5.50
Delayed Acquisition Decision	4	243,000,000	5.10
Operational Need/Maintain Production and Development	8	162,496,377	3.41
Proposal Problems	2	59,958,249	1.26
Prudent Business Decision	1	35,300,000	0.74
<b>Total</b>	<b>27</b>	<b>\$4,766,405,745</b>	<b>100.00</b>

SMC contracting personnel adequately justified issuing a UCA for all 27 UCAs and limited the usage to circumstances in which the negotiation of a definitive contract was not possible within the time available to meet Air Force requirements.

- **Multiple, Inseparable Issues** – SMC personnel issued five UCAs with multiple, inseparable issues that included funding gaps between contractor proposals and available budget, problems with the development of earlier portions of the acquisition, and delayed acquisition decisions by the Under Secretary of Defense for Acquisition, Technology, and Logistics.
- **Formation of Joint Venture** – SMC contracting personnel issued four UCAs related to the formation of a joint venture by the two principal contractors for the EELV program. UCAs were necessary because of funding gaps between contractor proposals and available budget, DCAA reviews of accounting procedures and proposal audits, lack of established forward pricing rate agreements, and lack of independent pricing rates for the joint venture.
- **Budget Reduction Issues** – SMC contracting personnel issued three UCAs because of funding uncertainties. In one instance, budget uncertainties delayed

the program schedule, and contracting personnel issued a UCA to avoid further program delays. In another, the usage of a UCA was planned upon the receipt of funding. In the third instance, a UCA was used to protect mission lead times after personnel from the National Reconnaissance Office withdrew funding to re-evaluate mission requirements.

- **Delayed Acquisition Decision** – SMC contracting personnel issued four UCAs because of delayed acquisition decisions. The Defense Advisory Working Group delayed the source selection decision on three occasions for the Transformational Communications Satellite program. The Under Secretary of the Air Force directed efforts to continue until the Defense Advisory Working Group completed their assessment. In another instance, SMC contracting personnel issued a 9-month bridge UCA to avoid work stoppage of advisory and assistance services because the approval process for the justification for other than full-and-open competition was not completed in time to award a definitive contract.
- **Operational Need/Maintain Production and Development** – SMC contracting personnel issued eight UCAs to fill urgent operational needs or maintain production and development. Urgent needs included production to support launches and launch capability. Maintaining production included UCAs used to continue efforts that impacted the production of critical components to support launches.
- **Proposal Problems** – SMC contracting personnel issued two UCAs because of proposal problems. One contractor provided proposals that were incorrectly referenced to their pre-proposal basis-of-estimate instead of the statement of work, and another contractor submitted inadequate and inconsistent proposals that required multiple updates and made negotiating a definitive price impossible.
- **Prudent Business Decision** – SMC contracting personnel issued one UCA as a prudent business decision in which they removed an administrative prime contractor and awarded a UCA to the subcontractor completing the majority of the efforts on the contract. SMC contracting personnel issued the UCA to maintain launch efforts.

The Assistant Secretary of the Air Force for Acquisition, in a December 2006 memorandum, directed that contracting personnel should not use UCAs as a normal means of conducting business. The memorandum further directed that the use of UCAs should be limited to circumstances in which negotiation of a definitive contract is not possible to meet Air Force requirements when performance must begin immediately.

## Documentation of a Fair and Reasonable Price

SMC contracting personnel adequately documented their determination of price reasonableness for 26 of the UCAs<sup>6</sup> except for not adequately documenting the determination of profit as discussed in this report. In addition, when determining price reasonableness for one UCA, SMC contracting personnel used a DCAA audit report that the DoD IG later recommended DCAA rescind because it could not be relied upon as a basis to negotiate fair and reasonable prices.

FAR 15.403-3, “Requiring information other than cost or pricing data,” requires that the contracting officer obtain information that is adequate for evaluating price reasonableness. Further, FAR 15.406-3, “Documenting the negotiation,” states that the contracting officer must document fair and reasonable price in the contract file. We reviewed the contract files for 26 of the UCAs and determined that the files contained adequate documentation, such as PNMs, business clearance memoranda, certificates of current cost or pricing data, and related audit reports to document contracting officers’ determination of price reasonableness.

SMC contracting personnel adequately documented their determination of fair and reasonable prices. FAR 15.404-4, “Profit,” states that the contracting officer’s signature on the PNM documents the contracting officer’s determination that the statutory price or fee limitations have not been exceeded. Contracting officers signed the PNM for 26 of the UCAs. According to the PNMs, contracting officers evaluated contractor proposals to determine that negotiated amounts were fair and reasonable. Table 8 shows the types of support contracting officers relied on when determining price reasonableness.

**Table 8. Documentation to Support Determination of Price Reasonableness**

<b>Contractor Proposal Evaluated Against</b>	<b>Number of PNMs That Identified Evaluation</b>
DCAA, Defense Contract Management Agency, and/or other audit agency audits	24
Technical evaluations	25
Forward pricing rate agreements or forward pricing rate recommendations	23

SMC contracting personnel referenced compliance with FAR 15.403-4, “Requiring cost or pricing data,” which outlines requirements for obtaining current cost or pricing data in the PNMs for 26 of the UCAs and the PNMs for 23 UCAs stated that the contractor provided a certificate of current cost or pricing data.

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<sup>6</sup> One UCA was definitized on September 13, 2010, but a completed price negotiation memorandum was not provided to the audit team so a full analysis could not be completed.

SMC contracting personnel used a DCAA report as partial support for the determination of price reasonableness for one UCA that the DoD IG later recommended be rescinded. DoD IG Report No. D-2009-6-009, "Defense Contract Audit Agency Audit Work Deficiencies and Abusive Work Environment Identified by the Government Accountability Office," August 31, 2009, recommended that DCAA rescind an audit report on a proposal received from one of the EELV providers. The DoD IG concluded that the report could not be relied upon by acquisition officials as a basis to negotiate fair and reasonable prices. The DoD IG determined that DCAA allowed the EELV provider to use lot accounting, which is not compliant with Cost Accounting Standards, and also allowed the inclusion of costs related to program management and hardware support efforts that were incurred before the initial contract issuance. Both GAO and the DoD IG questioned a contract line item for program management and hardware support costs on contract FA8816-06-C-0001, modification P00011. Although SMC contracting personnel adequately documented price reasonableness, they relied on a flawed DCAA audit report that the DoD IG identified as inadequate for determining fair and reasonable prices.

## **Change Orders**

SMC contracting personnel prepared contract documentation that either inappropriately identified change orders as UCAs or was ambiguous as to whether the action was a change order or a UCA for 10 UCAs. In addition, SMC contracting personnel referred to change orders as a type of UCA. The *SMC Contracting Directive*, March 29, 2007, required contracting personnel to treat change orders in the same manner as UCAs. As a result, SMC management may have difficulty accurately identifying and monitoring UCA and change order usage. However, differentiating between UCAs and change orders may soon become a moot point because a recent DFARS case is expected to result in new regulations to require contracting and program officials to apply the same restrictions to unpriced change orders that are applicable to UCAs.

## **UCAs and Change Orders**

The FAR Subpart 43.2 defines a change order as a clause within the contract that permits the contracting officer to make unilateral changes, in designated areas, within the general scope of the contract. UCAs are agreements that allow a contractor to begin work and incur costs before the Government and the contractor have reached a final agreement on contract terms, specifications, or price.

SMC contracting personnel issue change orders with attributes of and references to the usage of a UCA because the *SMC Contracting Directive* required contracting personnel to treat unpriced change orders as UCAs. Additionally, SMC contracting personnel issued change orders that contained attributes of UCAs such as a not-to-exceed price, a schedule for definitization, and approval for usage by SMC management. DFARS 217.74 exempts change orders from the restrictions applicable to UCAs but requires that contracting officers adhere to the guidance to the maximum extent practicable when using change orders. Table 9 highlights the differences between UCAs and change orders.

**Table 9. Differences Between UCAs and Change Orders**

Attribute	UCA	Change Order
Scope of the action	Out of Scope (new work)	Within Scope
Bilateral agreement	Yes	No*
Issued pursuant to:	10 U.S.C. § 2304(c)(2)	FAR 52.243
Obligation limitations	Yes	No
Request for equitable adjustment	No	Yes

\*To obtain the contractor's agreement on a definitization schedule and limitation of Government liability, some change orders are entered into bilaterally.

### ***Impact of SMC Treatment of Change Orders***

SMC management implemented procedures to improve the management and oversight of unpriced change orders. As a result, SMC contracting personnel issued change orders with elements of and references to the usage of a UCA. Additionally, SMC contracting personnel often referenced change orders as a type of UCA. SMC personnel provided a list of UCAs issued by SMC that included 10 actions that either omitted UCAs or did not clearly identify the actions as UCAs or change orders. SMC contracting personnel could have exceeded allowable obligation limitations by issuing a change order when the action should have been issued as a UCA. Additionally, the interchange of terms and references to UCAs when using change orders could create internal control, oversight, and tracking problems.

### ***Restrictions for Change Orders***

Defense Federal Acquisition Regulation Supplement Case 2008-D034 amended DFARS 217.74 to make requirements for DoD management and oversight of unpriced change orders consistent with the management and oversight requirements that apply to other UCAs. The audit team experienced challenges differentiating change orders from UCAs because guidance issued by SMC resulted in ambiguities in contract documentation. The amendment to DFARS 217.74 will make the differentiation unnecessary for future UCAs, because change orders will now be treated in the same manner as UCAs.

### ***Proactive Measures Taken***

Officials at higher levels within DoD have taken positive steps to ensure not only compliance with restrictions on the use of UCAs, but also to ensure that DoD spending is not wasteful. The Air Force Deputy Assistant Secretary (Contracting) Assistant Secretary (Acquisition) issued Policy Memo 10-C-03, "Undefinitized Contract Actions," on March 17, 2010, in response to the findings contained in GAO Report No. GAO-10-299, "Defense Contracting: DoD Has Enhanced Insight into Undefinitized Contract Action Use, but Management at Local Commands Needs Improvement." The policy memorandum reinforces the requirements that contracting officers should only obligate

funds consistent with the contractor's spend plan for the undefinitized period, work with contractors and DCAA to ensure that contractor proposals are adequate to support definitization, consider reducing or suspending progress payments when the contractor does not submit a timely qualifying proposal or does not otherwise support the established definitization schedule, and use the weighted guidelines tool throughout the negotiation process to make adjustments to the Air Force profit objective for costs incurred. The policy memorandum also established a management review and reporting requirement for any UCA that is more than 14 days behind schedule at any point in the definitization process. Additionally, the policy memorandum established a requirement that the Senior Contracting Official or the Senior Center Contracting Official and any members of the definitization team brief the appropriate Headquarters Air Force staff on the status of any UCA not definitized within 180-days of issuance. See Appendix F for a copy of the memorandum.

The SMC Director of Contracting stated in an October 22, 2010, memorandum that SMC considers proper management of UCAs of the utmost importance. SMC has executed a number of initiatives to definitize UCAs in a timely manner and reduce the number of UCAs in its portfolio. Since February 2010, SMC has reduced the number of open UCAs from 32 to 2. In addition, as of April 2010, the SMC Director of Contracting must authorize all UCAs.

## **Conclusion**

SMC contracting personnel properly obtained the appropriate authorization to issue UCAs, adhered to the limitations on the obligation of funds with three exceptions, and adequately documented their determination of price reasonableness. However, we identified 45 instances in which SMC personnel did not fully comply with UCA restrictions for 26 of 27 UCAs that we reviewed. SMC personnel:

- prepared a request to issue a UCA that provided insufficient detail to support the UCA request,
- did not definitize UCAs in a timely manner,
- did not reflect the reduced cost risk to the contractor during the undefinitized period in the contractor's profit,
- did not adequately document their consideration of contractor's reduced risk when determining contractor profit,
- did not obligate funds within allowable limits, and
- did not obligate funds according to contractor spending requirements.

As a result, the SMC position in the price negotiation and contract award may have been weakened, and delays in definitizing contracts may have increased the cost risk to the Government. Additionally, SMC personnel's failure to reflect the contractor's reduced risk during the undefinitized period in negotiated profit may have resulted in the Government paying more profit than was necessary. Incorporating the following recommendations should reduce the number of noncompliant actions.

## **Recommendations, Management Comments, and Our Response**

**We recommend that the Director of Contracting, Air Force Space and Missile Systems Center:**

**1. Develop a metric for measuring contractor responsiveness in preparing qualifying proposals.**

### ***Air Force Space and Missile Systems Center Comments***

The Director of Contracting, Air Force Space and Missile Systems Center agreed and stated that contractor responsiveness is being addressed in Board of Director Reviews, the Contractor Performance Assessment Reporting System reports, and Senior Executive periodic meetings and conferences. The Director of Contracting, Air Force Space and Missile Systems Center, also stated that proposal timeliness has been a major topic at the Program Executive Officer for Space quarterly benchmarking (Board of Director) sessions with Vice President-level Space and Missile Systems Center prime contractor personnel. The Director of Contracting, Air Force Space and Missile Systems Center, further commented that the proposal quality is considered in the preparation of all Contractor Performance Assessment Reporting System reports. She also commented that Air Force Space and Missile System Center Contracting personnel report on undefinitized contractual action metrics to the Air Force Deputy Assistant Secretary (Contracting) Assistant Secretary (Acquisition) twice a month. The Director of Contracting, Air Force Space and Missile Systems Center, stated the need for an additional responsiveness metric will be evaluated within 120 days after this report is issued.

### ***Our Response***

The Director of Contracting, Air Force Space and Missile Systems Center, comments are responsive. Air Force Space and Missile Systems Center officials have taken significant actions to address the contractor responsiveness issue. In addition to the actions presented by the Director of Contracting, Air Force Space and Missile Center, the Air Force Deputy Assistant Secretary (Contracting) Assistant Secretary (Acquisition) issued Policy Memorandum 10-C-03, “Undefinitized Contract Actions,” on March 17, 2010, which provided additional guidance that states that contracting officers must require contractor proposals to be valid for the time required to conduct the evaluation and audit. Because of these actions, Air Force Space and Missile Systems Center’s plan to evaluate the need for an additional metric is sufficient. No additional comments are required.

**2. Require that Air Force Space and Missile Systems Center contracting personnel minimize the use of undefinitized contractual actions by better coordinating with customers to identify changes in Government requirements in a timely manner and document changes in the acquisition narrative.**



### ***Air Force Space and Missile Systems Center Comments***

The Director of Contracting, Air Force Space and Missile Systems Center, agreed and stated that Air Force Space and Missile Center officials have taken actions to minimize the use of UCAs. She stated that those actions include issuing a memorandum rescinding approval for Space and Missile Systems Center Wing/Group Chiefs of the Contracting Office to issue UCAs; implementing the March 24, 2010, Office of the Assistant Secretary of the Air Force Policy Memorandum 10-C-04, “Timely Undefined Contract Action (UCA) Definization/Negotiated Awards-Contractor Responsiveness,” and communicating extensively with industry senior contracting representatives on the need to improve proposal timeliness, increase quality, and reduce UCA reliance. The Director of Contracting, Air Force Space and Missile Center, further stated that no UCAs have been issued since rescinding UCA approval authority from the Space and Missile Systems Center Wing/Group Chiefs of the Contracting Office.

### ***Our Response***

The Director of Contracting, Air Force Space and Missile Systems Center, comments are responsive. No additional comments are required.

**3. Update the *Space and Missile Systems Center Buyer’s Handbook* with emphasis on the importance of definitizing undefinitized contractual actions within 180-day time frames.**

### ***Air Force Space and Missile Systems Center Comments***

The Director of Contracting, Air Force Space and Missile Systems Center, agreed and stated that the recommendation would be implemented within 120 days after this report is issued.

### ***Our Response***

The Director of Contracting’s Air Force Space and Missile Systems Center’s comments are responsive. No additional comments are required.

**4. Update the *Space and Missile Systems Center Buyer’s Handbook* with guidance on how contracting personnel can document their consideration of reduced risk on the contractor’s profit or fee when definitizing undefinitized contractual actions. Additionally, the guidance should include instructions on how contracting personnel should develop and document the Government’s objective for profit or fee when definitizing an undefinitized contractual action.**

### ***Air Force Space and Missile Systems Center Comments***

The Director of Contracting, Air Force Space and Missile Systems Center, requested that the recommendation be revised; specifically to “update the Air Force Space and Missile Systems Center pricing guidance and training,” instead of to “update the *Space and Missile Systems Center Buyer’s Handbook*.” She also stated the Buyer’s Handbook would reference the pricing guidance for pricing-related issues. The Director of Contracting, Space and Missile Systems Center, stated the recommendation would be implemented within 120 days after this report is issued.

## ***Our Response***

The Director of Contracting, Air Force Space and Missile Systems Center, comments are responsive. The Director of Contracting, Air Force Space and Missile Systems Center, recommendation to update the Air Force Space and Missile Systems Center pricing guidance and training, and to reference the *Space and Missile Systems Center Buyer's Handbook* to the revised pricing guidance, meets the intent of the recommendation and does not require a revision to the recommendation. No additional comments are required.

**5. Update the *Space and Missile Systems Center Buyer's Handbook* with requirements for contracting personnel to include in the profit section of the price negotiation memorandum: incurred cost, contract type risk used for both the undefinitized period and remainder of the contract, and the impact that the use of the undefinitized contractual action had on the contractor's profit or fee. In addition, include instructions for contracting personnel to include and discuss inputs made to the contract type risk of DD Form 1547, "Record of Weighted Guidelines Application."**

## ***Air Force Space and Missile Systems Center Comments***

The Director of Contracting, Air Force Space and Missile Systems Center, requested that the recommendation be revised; specifically to "update the Air Force Space and Missile Systems Center pricing guidance and training," instead of to "update the *Space and Missile Systems Center Buyer's Handbook*." She also stated the Buyer's Handbook would reference the pricing guidance for pricing-related issues. The Director of Contracting, Space and Missile Systems Center, stated the recommendation would be implemented within 120 days after this report is issued.

## ***Our Response***

The Director of Contracting, Air Force Space and Missile Systems Center, comments are responsive. The Director of Contracting, Air Force Space and Missile Systems Center, recommendation to update the Air Force Space and Missile Systems Center pricing guidance and training, and to reference the *Space and Missile Systems Center Buyer's Handbook* to the revised pricing guidance, meets the intent of the recommendation and does not require a revision to the recommendation. No additional comments are required.

**6. Require contracting personnel to refrain from obligating funds to the maximum amount allowable for all undefinitized contractual actions so that both users and contractors have incentive to coordinate early and often about proposals, contractual needs, and funding.**

## ***Air Force Space and Missile Systems Center Comments***

The Director of Contracting, Air Force Space and Missile Systems Center, agreed and stated that Air Force Space and Missile Center personnel would comply with the March 17, 2010, Secretary of the Air Force for Acquisition Contracting

Policy Memorandum 10-C-03, and Defense Federal Acquisition Regulation Supplement 217.7404. She also stated that the recommendation would be implemented within 120 days after this report is issued.

### ***Our Response***

The Director of Contracting, Space and Missile Systems Center's, comments are responsive, and no additional comments are required. The Air Force Deputy Assistant Secretary (Contracting) Assistant Secretary (Acquisition) issued Policy Memorandum 10-C-03 on March 17, 2010, which reinforces the requirements that contracting officers should only obligate funds consistent with the contractor's spend plan for the undefinitized period.

## Appendix A. Scope and Methodology

We conducted this performance audit from October 2009 through September 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. We initially planned to review SMC's use of UCAs as part of a tri-Service audit beginning in July 2009. In September 2009, we decided to conduct a separate audit for each of the six contracting activities that we had initially identified to be included in the tri-Service audit.

GAO was conducting a review on the use of UCAs when our audit began. We limited our site selection to contracting offices that were not included in the GAO engagement.

### Universe and Sample Information

We used the FPDS-NG database to identify a universe of UCAs to review. We identified action obligations coded as letter contracts that the Air Force issued during calendar years 2004 through 2008. We classified the action obligations by contract number and contracting office code to identify the contracting offices responsible for the 15 largest aggregate UCA dollar values. We excluded two Air Force contracting organizations from consideration because GAO had an ongoing engagement with similar objectives at the sites. We identified SMC and the Air Force Electronic Systems Center for review. We then conducted another search in FPDS-NG to identify additional UCAs SMC contracting personnel issued from the beginning of FY 2004 to June 22, 2009. The FPDS-NG universe consisted of 522 SMC actions, valued at \$6,131,086,990, as of June 22, 2009. From the UCAs issued by SMC, we selected a nonstatistical judgmental sample of 12 letter contracts to review. In addition, SMC personnel provided a list of all UCAs issued by SMC contracting personnel from FY 2004 through September 18, 2009, that had a total not-to-exceed value of \$5,794,070,917.<sup>7</sup> However, the list of UCAs provided by SMC contained UCAs issued outside the scope of our review and contained change orders. Based upon the FPDS-NG data and the SMC data, we selected a nonstatistical judgment sample of 15 contracts that included 27 UCAs for review.

Our audit universe was limited to the contracts identified in FPDS-NG as letter contracts. Within FPDS-NG, we were unable to distinctively identify three types of UCAs: "provisioned item orders," "indefinite-delivery, indefinite-quantity," and "basic ordering agreements." These types of UCAs are identified in a field the user or input staff modifies and are subject to individual manipulations of the field that makes searching across the database unreliable. Our final nonstatistical judgmental sample consisted of 27 UCAs: 20 UCAs on 12 letter contracts and 7 UCAs issued as modifications to 3 definitized contracts. See Appendix C for a list of UCAs that we reviewed.

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<sup>7</sup> The list of UCAs provided by SMC personnel also included unpriced change orders, which we excluded from our nonstatistical judgmental sample.

## **Review of Documentation and Interviews**

We downloaded and reviewed selected contracts and modifications from the Electronic Document Access database and obtained and reviewed contract documentation from SMC. We then combined all of the data to perform an analysis to determine compliance with 10 U.S.C. § 2326. We determined through analyzing documentation and attending meetings whether the contracts underwent price reasonableness determinations before their definitization. We also determined whether SMC personnel complied with requirements from the August 29, 2008, DPAP memorandum that contracting officers should avoid obligating the maximum permissible funding at the time of UCA award.

We interviewed contracting, procurement, and automation officials about awarding and definitizing letter contracts and related management control programs at the:

- Office of Defense Procurement and Acquisition Policy;
- Department of the Air Force, Policy and Implementation;
- Air Force Space Command; and
- Air Force Space and Missile Systems Center.

We reviewed documentation maintained by SMC contracting personnel to support UCAs awarded or definitized from FY 2004 through September 18, 2009. We reviewed:

- UCA request and approval documentation,
- justification and approvals,
- statements of work,
- contract modifications,
- price negotiation memoranda,
- business clearance memoranda, and
- DCAA audit reports.

We evaluated documentation maintained by SMC against applicable criteria including:

- Statutes and Public Laws: Public Law 99-591, “Continuing Appropriations for Fiscal Year 1987”; Public Law 110-181, “National Defense Authorization Act for Fiscal Year 2008”; 10 U.S.C. § 2304, “Contracts: Competition Requirements”; 10 U.S.C. § 2326, “Undefinitized contractual actions: restrictions”;
- Federal Acquisition Regulation Requirements: FAR Subpart 6.3, “Other than Full and Open Competition”; FAR Subpart 15.4, “Contract Pricing”; FAR Subpart 16.6, “Time-and-Materials, Labor-Hour, and Letter Contracts”; FAR Subpart 52.2, “Text of Provisions and Clauses”;
- Defense Federal Acquisition Regulation Supplement: DFARS 215.404, “Proposal Analysis”; DFARS 216.6, “Time-and-Materials, Labor-Hour, and Letter Contracts”; DFARS 217.74, “Undefinitized Contract Actions”; DFARS case 2008-D034, “Management of Unpriced Change Orders”; DFARS case 2007-D011, “Letter Contract Definitization Schedule”;

- Air Force Federal Acquisition Regulation Supplement: Air Force Federal Acquisition Regulation Supplement Subpart 5316.6, “Time-and-Materials, Labor Hour, and Letter Contracts”; Air Force Federal Acquisition Regulation Supplement Subpart 5317.74, “Un definitized Contract Actions”; Air Force Federal Acquisition Regulation Supplement Subpart 5301.90, “Clearance”;
- Memoranda: Office of the Under Secretary of Defense for Acquisition, Technology, and Logistics memorandum, “Management Oversight of Un definitized Contract Actions,” August 29, 2008; the Department of the Air Force Office of the Assistant Secretary Contract Policy Memo 08-C-11, “Mandatory Procedures for Un definitized Contract Actions (UCAs),” October 14, 2008; Department of the Air Force, Deputy Assistant Secretary (Contracting), Assistant Secretary (Acquisition) Policy Memo 08-C-13, “Head of Contracting Activity (HCA) Designation and General Contracting Authority,” November 25, 2008; and
- Local Guidance: Commander, SMC, memorandum, “Redelegation of Specific Contracting Authorities,” January 9, 2003; Air Force Program Executive Officer for Space memorandum, “Re-delegation of Specific Contracting Authorities,” September 23, 2005; Air Force Program Executive Officer for Space memorandum, “Re-delegation of Specific Contracting Authorities,” February 12, 2006; SMC Contracting Memorandum, “Re-delegation of Head of Contracting Activity (HCA) Responsibilities,” December 22, 2008; *SMC Contracting Directive*, March 29, 2007; *SMC Buyer’s Handbook*, November 19, 2009.

## Use of Computer-Processed Data

We relied on computer-processed data from FPDS-NG to determine the contracting organizations to visit and to perform the audit nonstatistical judgmental sample selection. We also used Electronic Document Access to obtain contract documentation. The data were not a basis for our conclusions or finding. To assess the accuracy of computer-processed data, we verified the FPDS-NG and Electronic Document Access data against official records at visited contracting activities. We determined that data obtained through FPDS-NG and Electronic Document Access were sufficiently reliable to accomplish our audit objectives when compared with contract records.

## Use of Technical Assistance

We met with personnel from the DoD IG Quantitative Methods and Analysis Division and determined that we would use FPDS-NG data to select a nonstatistical judgmental sample of contracting activities and then we would use FPDS-NG data in combination with contract data provided by the contracting activity to select a nonstatistical judgmental sample of UCAs to review. Our nonstatistical judgmental sample was limited to specific contracts, and our results should not be projected across other SMC-issued contracts nor projected across Air Force-issued contracts.

## **Prior Coverage**

During the last 6 years, GAO has issued two reports discussing DoD use of UCAs, two reports related to space acquisitions, and two reports discussing audit issues within DCAA. During the last 6 years, the DoD IG has issued three reports discussing DoD use of UCAs and one report discussing audit issues within DCAA. Unrestricted GAO reports can be accessed over the Internet at <http://www.gao.gov>. Unrestricted DoD IG reports can be accessed at <http://www.dodig.mil/audit/reports>.

### **GAO**

GAO Report No. GAO-10-299, “Defense Contracting: DoD Has Enhanced Insight into Unfinitized Contract Action Use, but Management at Local Commands Needs Improvements,” January 28, 2010

GAO Report No. GAO-09-468, “DCAA Audits: Widespread Problems with Audit Quality Require Significant Reform,” September 23, 2009

GAO Report No. GAO-08-1039, “Space Acquisitions: Uncertainties in the Evolved Expendable Launch Vehicle Program Pose Management and Oversight Challenges,” September 26, 2008

GAO Report No. GAO-08-857, “DCAA Audits: Allegations That Certain Audits at Three Locations Did Not Meet Professional Standards Were Substantiated,” July 22, 2008

GAO Report No. GAO-07-559, “Defense Contracting: Use of Unfinitized Contract Actions Understated and Definitization Time Frames Often Not Met,” June 19, 2007

GAO Report No. GAO-06-908, “Defense Space Activities: Management Actions Are Needed to Better Identify, Track, and Train Air Force Space Personnel,” September 21, 2006

### **DoD IG**

DoD IG Report No. D-2011-001, “Marine Corps Systems Command’s Use of Unfinitized Contractual Actions,” October 27, 2010

DoD IG Report No. D-2010-080, “Air Force Electronic Systems Center’s Use of Unfinitized Contractual Actions,” August 18, 2010

DoD IG Report No. D-2009-6-009, “Defense Contract Audit Agency Audit Work Deficiencies and Abusive Work Environment Identified by the Government Accountability Office,” August 31, 2009

DoD IG Report No. D-2004-112, “Unfinitized Contractual Actions,” August 30, 2004

# Appendix B. August 29, 2008, Office of Defense Procurement and Acquisition Policy Memorandum\*



ACQUISITION,  
TECHNOLOGY  
AND LOGISTICS

OFFICE OF THE UNDER SECRETARY OF DEFENSE  
3000 DEFENSE PENTAGON  
WASHINGTON, DC 20301-3000

AUG 29 2008

MEMORANDUM FOR COMMANDER, UNITED STATES SPECIAL OPERATIONS  
COMMAND (ATTN: ACQUISITION EXECUTIVE)  
COMMANDER, UNITED STATES TRANSPORTATION  
COMMAND (ATTN: ACQUISITION EXECUTIVE)  
DEPUTY ASSISTANT SECRETARY OF THE ARMY  
(POLICY AND PROCUREMENT), ASA(ALT)  
DEPUTY ASSISTANT SECRETARY OF THE NAVY  
(ACQUISITION AND LOGISTICS MANAGEMENT),  
ASN(RDA)  
DEPUTY ASSISTANT SECRETARY OF THE AIR FORCE  
(CONTRACTING), SAF/AQC  
DIRECTORS, DEFENSE AGENCIES  
DIRECTORS, DOD FIELD ACTIVITIES

SUBJECT: Management Oversight of Undefinitized Contract Actions

An undefinitized contract action (UCA) is one for which the contract terms, specifications, or price are not agreed upon before performance is begun. Examples include letter contracts or undefinitized orders issued against basic ordering agreements or task/delivery order contracts. A UCA is a valuable tool for meeting urgent requirements. However, without appropriate management and controls, these instruments can lead to increased cost risks for the Department.

A recent Government Accountability Office (GAO) review of DoD UCAs (GAO-07-559) identified a need for enhanced oversight. In addition, section 809 of the FY 2008 National Defense Authorization Act requires issuance of detailed instructions to ensure oversight of UCAs. Specific issues include appropriate use of UCAs; timely definitization; obligation amounts prior to definitization; and appropriate recognition in profit or fee of the contractor's reduced risk during the undefinitized period.

DFARS 217.74, Undefinitized Contract Actions, provides DoD policies and procedures for the appropriate use of UCAs and related approval requirements. When possible, to discourage extended periods of performance prior to definitization, contracting officers should avoid obligating the maximum permissible funding at the time of UCA award. Contracting officers should assess the contractor's spend plan for the undefinitized period, and obligate funds only in an amount consistent with the




\* Attachments to the memorandum have been removed from the report.



contractor's requirements for the undefinitized period. In general, when negotiating profit or fee, it is appropriate to apply the contract risk factor for cost reimbursement contracts to the actual cost of performance prior to definitization (DD Form 1547, Record of Weighted Guidelines Application, Block 24, Contract Type Risk). Contracting officers should note the guidance at DFARS 215.404-71-3(d)(2) which indicates that, when costs have been incurred prior to definitization, generally the contract type risk should be regarded to be in the low end of the designated range. If a substantial portion of the costs have been incurred prior to definitization, contracting officers may assign a value as low as 0 percent, regardless of contract type. Contracting officers must document the risk assessment in the contract file.

To provide enhanced management insight and oversight of UCAs, we have established the attached templates for UCA Management Plans and semi-annual Consolidated UCA Reports for UCAs with an estimated value of more than \$5 million. Together, the plans and reports provide information on key aspects of UCA use and management, including actions taken to ensure timely and effective definitization. Initial UCA Management Plans are due no later than 30 days after the date of this policy memorandum. The initial Consolidated UCA Reports are due on 31 October 2008. Plan Updates and Consolidated UCA Reports are due semi-annually thereafter.

Please provide your UCA management point of contact as soon as possible to Mr. John Tenaglia who can be reached at [john.tenaglia@osd.mil](mailto:john.tenaglia@osd.mil) or 703-697-8334.



Shay D. Assad  
Director, Defense Procurement,  
Acquisition Policy, and  
Strategic Sourcing

Attachments:  
As stated

## Appendix C. Undefinitized Contractual Actions Reviewed

### Space and Missile Systems Center's Use of Undefinitized Contractual Actions for FY 2004–September 18, 2009

UCA Number	Contract Number	Modification Number	Description of Supplies or Services Procured	Contract <sup>1</sup> Type	Effective Date	NTE <sup>2</sup> Amount (millions)
1	FA8807-05-C-0001		Parts obsolescence study of existing components of the Rubidium Atomic Frequency Standard (RAFS) clock	CPFF	12/16/2004	\$.12
2		P00002	Replacement and/or redesign of obsolete parts and implementation of low risk-high yield improvements for the subsequent flight requalification of the Global Positioning System (GPS) Block IIF RAFS based on the parts obsolescence study	CPFF	9/14/2005	6.8
	FA8816-06-C-0002					
3		P00055	Continuous support of the Atlas V Launch Capability for the EELV program to include maintaining critical skills and supporting infrastructure and noninfrastructure-related activities	CPAF	10/1/2007	459.3
4		P00121	Air Force Space Command-2 (AFSPC-2) EELV Launch Capability Mission Unique Integration and Mission Unique Non-Flight Hardware, and AFSPC-2 Geo-Synchronous Orbit Kit	CPAF	11/6/2008	27.5
5		P00124	Increase the annual launch rate capability on the Atlas V EELV Launch Capability Contract	CPAF	1/16/2009	15.0
6	FA8807-07-C-0005		Build, install, and test a tertiary L5-frequency research and development demonstration payload on one GPS IIR-M Space Vehicle	CPFF	3/21/2007	6.0
7	FA8807-08-C-0006		Integrate the Selective Availability Anti-Spoofing Module 3.7 Key Data Processor IV (KDP-IV) and produce 150 Defense Advanced GPS Receivers with the 3.7 KDP-IV	FFP	4/1/2008	4.3
8	FA8808-06-C-0001		Wideband Global SATCOM Block II Non-Recurring Engineering and Advance Parts for Space Vehicle 4	FPIF	2/17/2006	148.2

## Appendix C. Unfinitized Contractual Actions Reviewed (cont'd)

### Space and Missile Systems Center's Use of Unfinitized Contractual Actions for FY 2004–September 18, 2009

UCA Number	Contract Number	Modification Number	Description of Supplies or Services Procured	Contract <sup>1</sup> Type	Effective Date	NTE <sup>2</sup> Amount (millions)
9	FA8810-08-C-0002		Long-lead effort for production of Space-Based Infrared Systems (SBIRS) geosynchronous orbit satellite #3 (GEO 3) and highly elliptical orbit payload #3 (HEO 3)	CPIF	3/14/2008	350.0
10		P00002	Production of the third SBIRS GEO 3 and HEO 3 and modification of the SBIRS ground system to accommodate operations of three HEO payloads simultaneously	CPAF	5/29/2009	1,487.4
11		P00007	Long-lead parts and material procurement for the fourth SBIRS GEO 4 and HEO 4	CPAF	7/10/2009	262.5
12	FA8810-09-C-0002		Advisory and Assistance Services to fulfill the program acquisition and execution responsibilities for the Overhead Non-Imaging Infrared/Overhead Persistent Infrared mission area	CPFF	3/31/2009	18.0
13	FA8811-08-C-0005		Delta Buy III Launch Services for the National Reconnaissance Office Launch (NROL)-32, NROL-27, and NROL-49 missions	FFP	1/24/2008	505.3
14	FA8811-09-C-0003		Delta Buy III Launch Services for NROL-15 mission	FFP	4/6/2009	184.0
15	FA8816-04-C-0001		EELV Space System Acquisition Strategy Evaluation	FFP	6/1/2004	.4
16	FA8819-08-C-0006		Start-up activities for the Space-Based Space Surveillance (SBSS) Block 10 Maintenance and Operations Requirements activities	CPFF	6/24/2008	35.3
17		P00002	12-month period of performance necessary to operate, support, and maintain the SBSS Block 10 Ground Segment, Space Vehicle, and associated support facilities	CPFF	12/22/2008	55.6

## Appendix C. Unfinitized Contractual Actions Reviewed (cont'd)

### Space and Missile Systems Center's Use of Unfinitized Contractual Actions for FY 2004–September 18, 2009

UCA Number	Contract Number	Modification Number	Description of Supplies or Services Procured	Contract <sup>1</sup> Type	Effective Date	NTE <sup>2</sup> Amount (millions)
	FA8816-06-C-0001					
18		P00011	Continuous support of the Delta IV Launch Capability for the EELV program to include maintaining critical skills and supporting infrastructure and noninfrastructure-related activities	CPAF	10/1/2007	582.3
19	FA8816-06-C-0004		Atlas V launch vehicle, including mission-unique airborne hardware, required to launch the Advanced Extremely High Frequency (AEHF) mission	FFP	2/28/2007	3.0
20	FA8816-06-C-0004	P00003	Begin work on the AEHF-2 mission launch to avoid any delays in schedule	FFP	8/29/2007	119.0
21		P00009	EELV Launch Services for NROL-41	FFP	12/19/2008	95.7
22		P00012	Atlas Buy 3 Launch Services for AFSPC-2	FFP	11/6/2008	145.2
	FA8808-04-C-0022					
23		P00043	6-month period of performance extension to synchronize Risk Reduction contract performance ending date with the schedule for the award of the Development & Production phase of the Transformational Communication Satellite (TSAT) Space Segment contract	CPFF	1/7/2008	75.0
24		P00046	6-month period of performance extension to synchronize Risk Reduction Systems Definition contract performance ending date with the schedule for the award of the Development & Production phase of the TSAT Space Segment contract	CPFF	6/6/2008	75.0
25		P00052	6-month period of performance extension to synchronize Risk Reduction Systems Definition contract performance ending date with the schedule for the award of the Development & Production phase of the TSAT Space Segment contract	CPFF	12/24/2008	75.0

## Appendix C. Undefined Contractual Actions Reviewed (cont'd)

### Space and Missile Systems Center's Use of Undefined Contractual Actions for FY 2004–September 18, 2009

UCA Number	Contract Number	Modification Number	Description of Supplies or Services Procured	Contract <sup>1</sup> Type	Effective Date	NTE <sup>2</sup> Amount (millions)
26	FA8814-08-C-0003		Payload Delivery Vehicle design, fabrication, integration, test, and CY 10 flight test support	CPFF	8/26/2008	12.2
27		P00006	Conventional Strike Missile activities through Preliminary Design Review	CPFF	5/15/2009	18.3

<sup>1</sup>FFP: firm-fixed-price; CPAF: cost-plus-award-fee; CPFF: cost-plus-fixed-fee; CPIF: cost-plus-incentive-fee; and FPIF: fixed-price-incentive-fee.

<sup>2</sup>NTE: not-to-exceed amount.

## Appendix D. Deficiencies Identified

### Detailed Results of Undefined Contractual Actions Reviewed

			Deficiencies in SMC Use of Undefined Contractual Actions				
UCA Number	Contract Number	Modification Number	Effective Date	Inadequate Request to Issue a UCA	Definitization Untimely	Obligation Limits Exceeded or Maximum Amount Obligated at Issuance	Profit <sup>1</sup>
1	FA8807-05-C-0001		12/16/2004				
2		P00002	9/14/2005		√		√
	FA8816-06-C-0002						
3		P00055	10/1/2007		√		
4		P00121	11/6/2008		√	√ <sup>2</sup>	
5		P00124	1/16/2009		√	√ <sup>2</sup>	
6	FA8807-07-C-0005		3/21/2007				√
7	FA8807-08-C-0006		4/1/2008		√		√
8	FA8808-06-C-0001		2/17/2006		√	√ <sup>3</sup>	√
9	FA8810-08-C-0002		3/14/2008		√		
10		P00002	5/29/2009		√	√ <sup>2</sup>	
11		P00007	7/10/2009		√	√ <sup>2</sup>	
12	FA8810-09-C-0002		3/31/2009		√		√
13	FA8811-08-C-0005		1/24/2008		√		
14	FA8811-09-C-0003		4/6/2009			√ <sup>2</sup>	
15	FA8816-04-C-0001		6/1/2004	√			
16	FA8819-08-C-0006		6/24/2008		√	√ <sup>3</sup>	√

## Appendix D. Deficiencies Identified (cont'd)

### Detailed Results of Undefined Contractual Actions Reviewed

UCA Number	Contract Number	Modification Number	Deficiencies in SMC Use of Undefined Contractual Actions				
			Effective Date	Inadequate Request to Issue a UCA	Definitization Untimely	Obligation Limits Exceeded or Maximum Amount Obligated at Issuance	Profit <sup>1</sup>
17	FA8819-08-C-0006	P00002	12/22/2008		√		
	FA8816-06-C-0001						
18		P00011	10/1/2007		√		
19	FA8816-06-C-0004		2/28/2007		√	√ <sup>3</sup>	√
20		P00003	8/29/2007		√		√
21		P00009	12/19/2008		√	√ <sup>2</sup>	√
22		P00012	11/6/2008		√	√ <sup>2</sup>	
	FA8808-04-C-0022						
23		P00043	1/7/2008				√
24		P00046	6/6/2008				√
25		P00052	12/24/2008			√ <sup>2</sup>	√
26	FA8814-08-C-0003		8/26/2008				√
27		P00006	5/15/2009			√ <sup>2</sup>	√
<b>Total</b>				<b>1</b>	<b>18</b>	<b>12</b>	<b>14</b>

√ Discrepancy noted.

<sup>1</sup>No reflection of reduced cost risk in negotiated profit or inadequate profit determination documentation.

<sup>2</sup>Obligated maximum amount allowable before definitization. Not in compliance with August 2008 DPAP memo.

<sup>3</sup>Exceeded 10 U.S.C. 2326(b) limits.

## Appendix E. Definitization Elapsed Days for SMC UCAs

Space and Missile Systems Center's Definitization Details for FY 2004—September 18, 2009

Contract Number	Effective Date	Qualifying Proposal Date	Definitization Date	Days From Award to Receipt of Qualifying Proposal	Days From Receipt of Qualifying Proposal to Definitization	Days From Award to Definitization
FA8807-05-C-0001	12/16/2004	2/23/2005	4/6/2005	69	42	111
P00002	9/14/2005	5/19/2006	6/30/2006	247	42	289
FA8816-06-C-0002						
P00055	10/1/2007	5/25/2007	6/26/2008	Received before UCA award date	N/A	269
P00121	11/6/2008	11/7/2008	6/15/2009	1	220	221
P00124	1/16/2009	9/17/2009	9/30/2009	244	13	257
FA8807-07-C-0005	3/21/2007	7/27/2007	11/27/2007	128	123	251
FA8807-08-C-0006	4/1/2008	3/14/2008	10/15/2008	Received before UCA award date	N/A	197
FA8808-06-C-0001	2/17/2006	12/16/2005	10/17/2006	Received before UCA award date	N/A	242
FA8810-08-C-0002	3/14/2008	11/21/2008	4/8/2009	252	138	390
P00002	5/29/2009	3/21/2009	6/3/2010	Received before UCA award date	N/A	370
P00007	7/10/2009	3/21/2009	6/3/2010	Received before UCA award date	N/A	328
FA8810-09-C-0002	3/31/2009	5/20/2009	12/29/2009	50	223	273
FA8811-08-C-0005	1/24/2008	1/19/2009	8/17/2009	361	210	571
FA8811-09-C-0003	4/6/2009	1/23/2009	8/17/2009	Received before UCA award date	N/A	133
FA8816-04-C-0001	6/1/2004	7/14/2004	9/30/2004	43	78	121
FA8819-08-C-0006	6/24/2008	10/23/2008	10/15/2009	121	357	478
P00002	12/22/2008	6/18/2009	1/14/2010	178	210	388
FA8816-06-C-0001						
P00011	10/1/2007	6/11/2007	8/1/2008	Received before UCA award date	N/A	305
FA8816-06-C-0004	2/28/2007	4/16/2007	10/31/2007	47	198	245
P00003	8/29/2007	8/8/2007	5/13/2008	Received before UCA award date	N/A	258



## Appendix E. Definitization Elapsed Days for SMC UCAs (cont'd)

Space and Missile Systems Center's Definitization Details for FY 2004—September 18, 2009

Contract Number	Effective Date	Qualifying Proposal Date	Definitization Date	Days From Award to Receipt of Qualifying Proposal	Days From Receipt of Qualifying Proposal to Definitization	Days From Award to Definitization
FA8816-06-C-0004						
P00009	12/19/2008	12/23/2008	9/10/2009	4	261	265
P00012	11/6/2008	11/26/2008	9/13/2010	20	656	676
FA8808-04-C-0022						
P00043	1/7/2008	2/29/2008	5/19/2008	53	80	133
P00046	6/6/2008	8/8/2008	10/22/2008	63	75	138
P00052	12/24/2008	2/20/2009	5/1/2009	58	70	128
FA8814-08-C-0003	8/26/2008	12/19/2008	2/27/2009	115	70	185
P00006	5/15/2009	7/1/2009	12/11/2009	47	163	210

# Appendix F. Air Force Policy Memorandum 10-C-03



DEPARTMENT OF THE AIR FORCE  
WASHINGTON, DC

MAR 17 2010

OFFICE OF THE ASSISTANT SECRETARY

Policy Memo 10-C-03

MEMORANDUM FOR ALMAJCOM/FOA/DRU (CONTRACTING)  
ALL AFPEO

FROM: SAF/AQC  
1060 Air Force Pentagon  
Washington, DC 20330-1060

SUBJECT: Undefinitized Contract Actions

Defense Federal Acquisition Regulation Supplement (DFARS) Subpart 217.74, Undefinitized Contract Actions (UCAs), implements 10 U.S.C. 2326 and provides Department of Defense (DoD) policies and procedures for the appropriate use of UCAs and related approval requirements. It is DoD policy that UCAs should be used on an infrequent basis for clearly defined, urgent requirements and must be definitized within the established schedule.

DFARS 217.7404-3 states that UCAs shall be definitized within 180 days after issuance. Unfortunately, the latest Air Force (AF) Consolidated UCA Management Report indicates the majority of AF UCAs are not being definitized within the established schedule. In addition, this report indicates contracting officers are regularly obligating the maximum permissible funding at the time of UCA issuance. In a recent assessment of the use of UCAs throughout DoD, the General Accountability Office (GAO) similarly found that most UCAs are issued at or near the maximum obligation allowed, 50% of the not-to-exceed amount. Further, the GAO review also found that, in many cases, contractor incurred costs during the undefinitized period were well below the maximum amount obligated. This particular finding highlights the importance of the relationship between the contractor's spend plan and the Government's obligation of funds during the definitization period. Obligating funds in excess of the contractor's spend plan encourages extended periods of performance prior to definitization. Therefore, contracting officers must only obligate funds consistent with the contractor's spend plan for the undefinitized period.

DFARS 217.7401 defines a "qualifying proposal" as a proposal containing sufficient information to conduct complete and meaningful analyses and audits of the information in the proposal or connected with the contract. In accordance with FAR 15.408, contracting officers must provide the contractor with clear and concise proposal instructions to include a suspense date for proposal submission. Contracting officers may reference DCAA Pamphlet 7641.90, January 2005, and the Criteria for Adequate Contract Pricing Proposal Checklist, September 2009, to assist contractors in understanding applicable requirements and to help facilitate the contract audit process. Contracting officers must require that contractor proposals (both prime and subcontractors) are valid for the time required to conduct the evaluation and audit. Additionally, the DCAA Contract Audit Manual, DCAAM 7640.1, outlines the audit process to include engaging with the contracting officer to establish agreed upon procedures for the audit. It is

necessary that contracting officers work with DCAA in an effort to ensure contractor proposals are adequate to support definitization.

UCAs create potential risk to the taxpayer as contractors may lack incentives to control costs during the undefinitized period. Every request for a proposal update due to changing requirements, proposal expirations, lack of adequate supportable information for audit, etc., may result in additional proposal costs whether they are charged as a direct or indirect cost. DFARS 217.7404-3(b) and the Progress Payments clause provide the Government the right to reduce or suspend progress payments under specified conditions. Contracting officers should consider reducing or suspending progress payments (FAR 32.503-6) when the contractor does not submit a timely qualifying proposal or has otherwise not supported the established definitization schedule.

The GAO review documented inconsistencies in how contracting officers evaluate cost risk for incurred costs. This finding is consistent with a prior DoDIG report which stated that UCAs transfer additional cost and performance risks from contractors to the Government because in most cases, the contractor is reimbursed for all allowable costs incurred. With all allowable costs reimbursed, the contractor has reduced incentive to control costs. DFARS 217.7404-6 provides basic guidance for conducting profit/fee negotiations, and properly accounting for contractor risk, during the definitization process. Contracting officers must also adhere to the guidance at DFARS 215.404-71-3(d)(2) which indicates that, when costs have been incurred prior to definitization, generally the contract type risk should be regarded to be in the low end of the designated range. If a substantial portion of the costs have been incurred prior to definitization, contracting officers may assign a value as low as 0 percent, regardless of contract type. AFMC maintains a web-based Weighted Guidelines program available at <https://www.wgl.wpafb.af.mil/wgl/>. This web-based tool provides the capability to address incurred costs in the profit analysis for UCAs and is available for all AF contracting organizations. Contracting officers must use this tool throughout the UCA negotiation process to make adjustments to the AF profit objective for costs incurred.

The manner in which Contractor Performance Assessment Reporting System (CPARS) Assessing Officials are rating contractor performance in the area of Management Responsiveness/Business Relations (Block 18d) has been a focus area during recent UCA reviews performed by AQC. Findings indicate that CPARS Assessing Officials are assigning little, if any, significance to contractor performance under UCAs, to include contractor performance in the timely submission of quality proposals in support of the definitization of the contract action when assigning overall performance ratings. Assigned CPAR ratings must track to the definitions provided in Attachment 2, "Evaluation Ratings Definitions" to the DoD CPARS Policy Guide. A singular performance problem, such as the failure to submit a timely, complete and quality proposal (or subsequent data submissions), in connection with a UCA is of such serious magnitude that it alone justifies an unsatisfactory (red) rating in the assessment of Management Responsiveness (Block 18d of a CPAR for Systems) or Business Relations (Block 18d of a CPAR for Services, Information Technology, or Operations Support). When completing Block 20 Assessing Official Narrative, Assessing Officials must fully explain the contractor's performance during the UCA, including definitization of the contract action, shall base the assessment on factual, objective data, and shall support the adjectival/color ratings

assigned to area assessments. Moreover, rather than waiting until the next scheduled Intermediate Report is due, Assessing Officials should give serious consideration to processing an out-of cycle report if a significant change during performance under a UCA as described above alters the assessment in one or more assessment areas.

FAR 1.602-2 states contracting officers are responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contract, and safeguarding the interests of the United States in its contractual relationships. SAF/AQ Memo, Air Force Acquisition Business Rules of Engagement, dated February 2010, states contract lead times should not be based on the use of UCAs, which should be used only for exceptional cases. Therefore, program managers and contracting officers have the responsibility to ensure UCAs are used on an infrequent basis for clearly defined, urgent requirements and are definitized within the established schedule.

To assure that UCAs are definitized effectively, I am establishing a management review and reporting requirement for any UCA that falls more than 14 days behind its schedule at any point in the definitization process. The cognizant SCO/SCCO must review each such UCA monthly and provide the DAS(C) a status report identifying the remedial actions that have been or are being taken with respect to the UCA. The report, in e-mail format, shall be sent to [safaqck.workflow@pentagon.af.mil](mailto:safaqck.workflow@pentagon.af.mil). Further, the DAS(C) shall require the SCO/SCCO and any members of the definitization team to brief the appropriate HAF staff on the status of any UCA not definitized within 180 days of issuance.

If you have any questions, please contact [REDACTED] SAF/AQCP, at (703) 588-7071, DSN 425-7071 [REDACTED]

Deputy Assistant Secretary (Contracting)  
Assistant Secretary (Acquisition)

# Air Force Space and Missile Systems Center Comments



**DEPARTMENT OF THE AIR FORCE**  
HEADQUARTERS SPACE AND MISSILE SYSTEMS CENTER (AFSPC)  
LOS ANGELES AIR FORCE BASE, CALIFORNIA

NOV 15 2010

MEMORANDUM FOR HQ DOD IG

FROM: SMC/PK

SUBJECT: DoD OIG Draft Audit Report "Air Force Space and Missile Systems Center's Use of Unfinalized Contractual Actions," (Project No. D2009-D000CG-0248.002) dated September 29, 2010

1. The Space and Missile Systems Center (SMC) considers proper management of Unfinalized Contractual Actions (UCA) of the utmost importance. SMC has executed a number of initiatives to definitize UCAs in a timely manner and reduce the number of UCAs in its portfolio. Since Feb 2010, SMC has reduced the number of open UCAs by 94.8 percent going from 32 to 2. In addition, in Apr 2010, the SMC Director of Contracting rescinded previously existing UCA approval delegations, therefore UCAs can now only be authorized by the Director of Contracting.

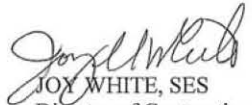
2. IAW AFI 65-301, Audit Reporting Procedures, we are providing the following comments to your audit recommendations:

- **Recommendation 1 – page 30:** Develop a metric for measuring contractor responsiveness in preparing qualifying proposals.
- **COMMENT:** SMC/PK Concurs with this comment. SAF/AQC manages a robust UCA tracking metrics. SMC/PK completes and reports on this metrics twice a month. Additionally, responsiveness is addressed in different forums such as Board of Director Reviews, Contractor Performance Assessment Reporting System (CPARS), Senior Executive periodic meetings and conferences. The Program Executive Officer for Space (PEO/SP) conducts quarterly Benchmarking (Board of Director) sessions with Vice President level SMC prime contractor personnel. At these events, significant areas of concern are addressed with suspenses given for resolution. The issue of proposal timeliness has been a major topic at these forums. PEO/SP also holds quarterly Program Management Reviews with each Wing at which contractor CPARS and award fee data are reviewed. In terms of CPARS, the matter of proposal quality is considered in the preparation of all CPARS reports and the Wings comment on those that are not done properly. The need for any additional responsiveness metric will be evaluated. Estimated Completion Date: 120-Days after issuance of the formal audit report.
- **Recommendation 2 – page 30:** Require that Air Force Space and Missile Systems Center contracting personnel minimize the use of unfinalized contractual actions by better coordinating with customers to identify changes in Government requirements in a timely manner and document changes in the acquisition narrative.

- **COMMENT:** SMC/PK Concur with this comment. The significant center-level emphasis on UCAs and the singular authority of UCA issuance (SMC/PK) have established an environment where program personnel are responsive to the Director of Contracting's guidance regarding up front planning to avoid UCAs. This is evident in the fact that no UCAs have been issued since the Director of Contracting issued a memo, rescinding approval for SMC Wing/Group Chiefs of the Contracting Office (COCO) to issue UCAs. Additionally, SMC/PK personnel are implementing the Office of the Assistant Secretary of the Air Force Memorandum 10-C-04, dated March 24, 2010. Moreover, SMC/PK has communicated extensively with industry senior contracting representatives on the need to improve proposal timeliness, increase quality and reduce UCA reliance. SMC/PK considers this action complete.
- **Recommendation 3 – page 30:** Update the Space and Missile Systems Center Buyer's Handbook with emphasis on the importance of definitizing undefinitized contractual actions within 180-day time frames.
- **COMMENT:** SMC/PK Concur with this comment. The buyers handbook shall be updated. Estimated Completion Date: 120-Days after issuance of the formal audit report.
- **Recommendation 4 – page 31:** Update the Space and Missile Systems Center Buyer's Handbook with guidance on how contracting personnel can document their consideration of reduced risk on the contractor's profit or fee when definitizing undefinitized contractual actions. Additionally, the guidance should include instructions on how contracting personnel should develop and document the Government's objective for profit or fee when definitizing an undefinitized contractual action.
- **COMMENT:** We request your recommendation be revised to include "Update the Space and Missile Systems Center pricing guidance and training" instead of "Update the Space and Missile Systems Center Buyer's Handbook." The Buyers Handbook will reference the pricing guidance for pricing related issues. Estimated Completion Date: 120-Days after issuance of the formal audit report.
- **Recommendation 5 – page 31:** Update the Space and Missile Systems Center Buyer's Handbook with requirements for contracting personnel to include in the profit section of the price negotiation memorandum: incurred cost, contract type risk used for both the undefinitized period and remainder of the contract, and the impact that the use of the undefinitized contractual action had on the contractor's profit or fee. In addition, include instructions for contracting personnel to include and discuss inputs made to the contract type risk of DD Form 1547, "Record of Weighted Guidelines Application."
- **COMMENT:** We request your recommendation be revised to include "Update the Space and Missile Systems Center pricing guidance" instead of "Update the Space and Missile Systems Center Buyer's Handbook." The Buyers Handbook will reference the pricing guidance for pricing related issues. Estimated Completion Date: 120-Days after issuance of the formal audit report.

- **Recommendation 6 – page 31:** Require contracting personnel to refrain from obligating funds to the maximum amount allowable for all undefinitized contractual actions so that both users and contractors have incentive to coordinate early and often about proposals, contractual needs, and funding.
- **COMMENT:** SMC/PK Concurs with this comment. We will ensure DFAR 217.7404-4, Limitations on Obligations, and SAF/AQC Policy Memo 10-C-03 dated March 17, 2010 “Undefinitized Contract Actions” are complied with. Estimated Completion Date: 120-Days after issuance of the formal audit report.

3. Please contact [REDACTED] SMC Audit Focal Point, [REDACTED] with questions.

  
JOY WHITE, SES  
Director of Contracting





# Inspector General Department of Defense

